Company Registration No. 4406777

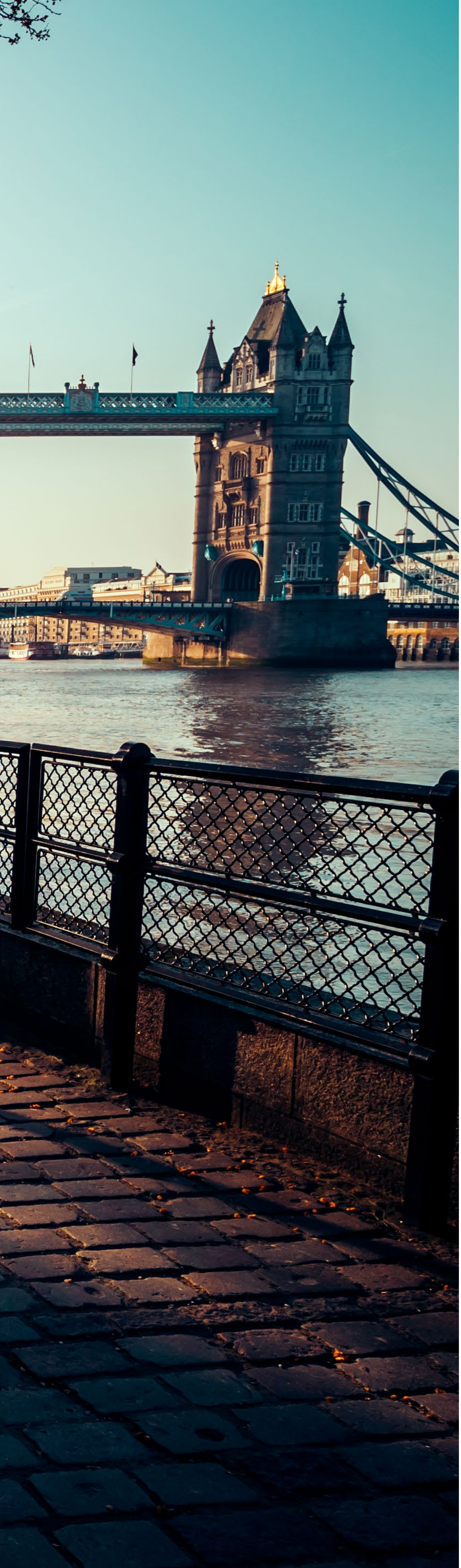
# Bank of Beirut (UK) Ltd

Report and Financial Statements
31 December 2018

Report and financial statements 2018

# Table of Contents


| | |
|---|---|
| Officers and professional advisers | 5 |
| Chairman's statement | 7 |
| Strategic report | 8-13 |
| Directors' report | 13-15 |
| Statement of directors' responsibilities | 16 |
| Independent auditor's report | 16-23 |
| Income statement | 24 |
| Statement of other comprehensive income | 24 |
| Balance sheet | 25 |
| Statement of changes in equity | 26 |
| Cash flow statement | 27 |
| Notes to the financial statements | 28-64 |



# Report and financial statements 2018
# Officers and professional advisers

### Directors

Salim G Sfeir (Chairman)

Sophoklis Argyrou

Martin Osborne

Fawaz H Naboulsi

Marcus John S Trench

Anthony J Bush

Ramzi Saliba

Antoun Samia

### Secretary
Comat Registrars Limited – Resigned 30.01.2018

### Registered office
66 Cannon Street
London
EC4N 6AE

### Bankers
Royal Bank of Scotland PLC
1st Floor, 280 Bishopsgate
London
EC2M 4RB

### Solicitors
Evershed LLP
1 Wood Street
London
EC2V 7WS

### Auditor
Deloitte LLP
Statutory Auditor
London, United Kingdom

# Chairman´s Statement

Brexit, the result of the UK's decision in March 2017 to invoke Article 50 to leave the EU, has dominated political, social and financial events across the UK and Europe during the past two years. To date there have been no conclusive decisions reached between the UK and EU around the withdrawal process culminating in the UK government seeking an extension on the UK's 29 March 2019 exit date. As a result, Financial Institutions and the wider business community globally continue to operate and trade in a market that is unable to deliver any certainty and stability from which to make informed, strategic and measured decisions.

For Bank of Beirut (UK) Ltd, the continuous uncertainty around the exit of the UK from the EU has led the Board of the Bank to take definitive action by announcing in February 2019 the closure of our Frankfurt Branch which is licenced under an EU Passport. Whilst, strategically this has been a difficult period for the Bank and our colleagues in Germany, we remain confident that Frankfurt Branch's business transactions, which are primarily trade related, will continue to be managed and handled by our London office.

On a positive note, as one Branch closes, we are delighted to announce the opening of the Bank's new London Headquarters located at 66 Cannon Street in the heart of the City of London financial district. With the support of the Bank of Beirut Group and its Shareholders through a subordinated loan made in 2018, the building was purchased in September 2017, and after an extensive building and refurbishment programme the new premises were finally opened to staff and our customers in December 2018. This achievement provides the Bank with the solid foundations required to support its continued expansion, growth and profitability in the future.

Reflecting on our financial performance in 2018, Interest Income grew by 21.8% to £13.2m (2017 - £10.9m) which contributed to strong overall gross revenues including our fees and commissions for the year of £22.7m (2017 - £21.6m). This has been achieved in part through higher than average trade assets booked during the third quarter of 2018 on the strength of increased Export Letters of Credit (LCs) processed in previous quarter. During the year we handled just short of 3,300 Export LCs with a 5% higher volume in actual USD terms than seen in 2017. Proportionately however, a greater number of these LCs were unconfirmed and combined with increased competition and pricing in our core West African markets together with some political nervousness seen in Nigeria ahead of elections in early 2019, we were unable to fully match those commission levels of prior year.

Taking into consideration the substantial increase in premises related overheads of approximately £1.2m attributed to the acquisition of the new building, the effects of implementing IFRS9 ECL charges for the first time and the allocation of further specific loan impairments £1.03m (2017 - £0.5m) the Bank generated a profit after tax of £5.56m (2017 - £7.42m).

In terms of Balance Sheet, our total liabilities and equity closed at £607.9m (2017 - £520.8m) an increase of 16.75% year on year, driven by a steady increase in customer deposits, the drawdown of the new subordinated loan and higher deposits seen from our group and other correspondent banks. On the asset side, a proportion of this increase is reflected in our Loans and advances to customers, closing the year up at £191.4m (2017 - £178.3m) whilst our short term placements and balances with banks reflect the liquidity being held in the business as we wind down our Frankfurt Branch business. As a consequence the Bank's Total Capital Ratio has strengthened to 35.12% (2017 – 28.45%) and our Common Equity Tier 1 (CET1) Capital Ratio to 26.36% (2017 – 24.35%) whilst our liquidity coverage ratio closed the year at 288.77% (2017 – 192.14%). As at 31 December 2018 total shareholders' funds including subordinated loans and retained earnings now stands at £133.3m (2017 - £111.4m) which also includes the opening IFRS9 adjustment of £1.38m charged to retained earnings following adoption from 1 January 2018.

These achievements are not possible without the support and dedication of the Bank's Board, management, staff, customers and shareholders to whom we are truly thankful.

Salim G. Sfeir
Chairman
25 April 2019

# Strategic Report

Bank of Beirut (UK) Ltd (the Bank) is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. It commenced its UK operations in December 2002 although historically the Bank has maintained a presence in London since 1981 providing important retail deposit and payment services to the Lebanese community based in the UK and overseas.

As the only fully licenced Lebanese owned Bank in the UK, our aim is to leverage on the Banks affinity with Lebanon and its diaspora. The Bank markets itself primarily as a trade finance boutique house, with a correspondent banking network reach to all major export geographies, specialising in all aspects of Export Trade Finance with an established coverage of Financial Institutions across Western Africa and to a lesser extent Eastern and Northern African countries. In addition, we act as a confirming house for a number of Lebanese and other Banks operating in the Middle Eastern region. Our comprehensive service covers the full range of Trade Finance products, the financing of which is primarily of a short dated nature (up to 180 days) but with occasional medium term transactions.

To supplement its trade activities the Bank also provides traditional lending services to its retail and corporate clients with a loan book just below £60m and at the same time under our UK deposit taking license a modest retail deposit base which is currently just under £105m. All eligible deposits are covered by the Deposit Protection Scheme which is overseen by the Financial Services Compensation Scheme (FSCS).

For the past 10 years the Bank has also operated a branch out of Frankfurt, Germany by virtue of the EU passport licencing arrangements, providing specialised trade finance products and services to the German market and other neighbouring countries. Sadly, in the light of continuing uncertainty around the UK exit from the European Union, the Board has recently taken the decision to close down the Frankfurt Branch and wind down its operations. The Bank is confident that those business relationships already established across the past 10 years can be maintained and supported from our new flagship headquarters in London.

## Performance highlights

For the period to 31 December 2018, the Bank generated a Profit after Tax of £5.56m (2017 - £7.42m), which included additional expenditure incurred during the year related to the acquisition and refurbishment of the new Head Office building located at 66 Cannon Street. Project costs not previously incurred amounted to £1.2m of which subordinated loan financing costs from our Parent accounted for £757k.

Under the newly adopted IFRS 9 (replacing IAS 39), reporting and accounting for loan impairments is now calculated based on the expected loss model. The Bank recorded an opening ECL charge of £1.38m which was within the range of £1.0m to £1.5m reported in our 2017 Financial Statement and Accounts and this amount has been set against the Bank's retained earnings as required. Taking into account movements within the Loan book across 2018 and combined with the allocation of additional Specific Provisions a final charge of £1.03m (2017 - £0.5m) has been allocated against Profit and Loss for 2018.

In terms of operational business as usual performance, Net Interest Income for the year achieved £7.81m being 7% ahead of prior year (2017 - £7.30m) but which includes discount income of £0.5m received from the Bank's treasury bill holdings previously recorded within non-interest income. Although base rate rises during the year further supplemented the increased return we also saw significant trade related advances from the middle part of 2018. Unfortunately, trade volumes could not be maintained leading to a consequent reduction in the Loan book from a peak of £231m in August to £192m by end December.

Net Commission Income for year achieved a solid £9.00m (2017 - £10.17m) reflecting the aforementioned slowdown in trade activity during the second half of 2018 together with the restatement of discount income. The slowdown can be attributed to a number of factors; nervous markets ahead of the Nigerian elections which took place in February 2019, Ghanaian Banks under pressure to recapitalise and meet local central bank requirements leading to a reduced appetite and restricted credit line availability for select banks working towards meeting their minimal capital and stricter pricing being applied as market competition has increased. In addition, we saw a greater proportion of advised (unconfirmed) Letters of Credit with only nominal fee income derived from these transactions hence the lower overall commissions.

Positively, despite the increased overheads and increased charges for impairments during 2018, the Bank has seen its core Total Capital ratio increase to 35.12% (2017 – 28.45%) on account of increased equity and retained earnings. Total capital resources as at 31 December 2018 stand at £133.3m (2017 - £111.4m).

## Looking forward

In December 2018 the Bank proudly opened its doors at its new London Head Office on Cannon Street to business. This was achieved after several months of hard work and effort by the Bank's staff and external contractors appointed on behalf

# Strategic Report (continued)

## Looking forward (continued)

of the Bank to complete the refurbishment program. This could not have been achieved however without the continued support of our Parent and shareholders through the provision of a term subordinated loan. Occupation of our new offices will herald another chapter for the Bank going forward and bring with it increased opportunity and continued growth through the enhancement of technology and in turn availability of a wider suite of products and services.

With the conclusion of elections in Nigeria in early 2019, we can expect a return to pre-election trade volumes by the end of quarter two, albeit that a more competitive environment requires dynamic pricing in order to sustain our market share. With our continued commitment and support for these markets including Ghana, we are confident that through diligent marketing efforts and risk management that the Bank will continue to remain competitive in 2019 and beyond. Indeed to further strengthen our footprint in the region our Parent has committed to grow its support team working on a daily basis in Nigeria.

Inevitably the decision to close and wind down our Frankfurt Branch during 2019 will impact the Bank overall in terms of direct overheads and incurred costs, whilst at the same time working towards managing and retaining market share of the business developed in the previous 10 years. We believe that the goodwill already established through relationships both on the applicant side and with beneficiaries alike will continue to develop and grow.

With the support of our Shareholder, Bank of Beirut Sal Group and all stakeholders we believe that we are well placed to realise and meet its business strategy and objectives in 2019 and beyond.

## Payment of Dividends

The Directors have not recommended the payment of any dividend.

The financial statements for the reporting year ended 31 December 2018 are shown on pages 24 to 27.

## Key performance indicators and ratios

The financial performance for the year to 31December 2018 is summarised in the following table
(All figures are quoted in GBP ‘000s):

| Income Statement | 2018 | 2017 |
|---|---|---|
| Net interest income | 7,815 | 7,301 |
| Fees and other income | 9,477 | 10,718 |
| Total operating income | 17,292 | 18,018 |
| Operating expenses | 9,472 | 8,149 |
| Profit before provisions & taxes | 7,820 | 9,869 |

| Balance Sheet | 2018 | 2017 |
|---|---|---|
| High Quality Liquid Assets | 180,011 | 104,355 |
| Loans and advances to customers | 191,403 | 178,336 |
| Total assets | 607,982 | 520,774 |
| Total Deposits | 461,925 | 399,369 |
| Shareholders’ funds* | 133,354 | 111,431 |

| Key performance indicators (%) | 2018 | 2017 |
|---|---|---|
| Capital Adequacy Ratio | 35.12% | 28.45% |
| Liquidity Coverage Ratio | 288.77% | 192.14% |
| Net Interest Margin | 1.43% | 1.48% |
| Cost to income ratio | 56.00% | 47.16% |
| Return on Average Equity | 5.53% | 7.85% |

* Includes Bank of Beirut Group Term Subordinated Loan

# Strategic Report (continued)

## Correspondent Banking and Trade Services

The Bank has long established its primary markets for the provision of treasury, trade finance and payments services to its trade finance related correspondent bank counterparties. The Bank's strategy is aligned with its Parent bank to deliver and support the finance of trade between the UK and continental Europe and exports to the Middle East and African regions. Those countries and markets are continuously reviewed and monitored with a view to expansion and growth opportunities.

Services include but are not limited to confirmation and advising of Letters of Credit, Issuance of Letters of Guarantees and Standby LCs, Acceptances, documentary collections, trade advances including discounting, forfaiting, and post finance. Transactions are generally short term in nature for a maximum 180 days.

The Bank maintains a strong trade finance team with additional support provided by its marketing consultants and through the group representative offices.

## Corporate and Commercial Banking

The Bank complements its key trade services products with traditional corporate and commercial lending products and services to enhance trade and investment opportunities between the UK, Europe, West Africa and Lebanon. Structuring of lending facilities revolves around the requirements of the borrower but with particular appetite to financing of trade related businesses and real estate backed facilities.

## Retail Banking

The Bank provides a selection of retail products and services to its customers covering Current Accounts, Call Deposit Accounts, Fixed Term Deposits and the provision of payment and clearing services. Our customer geographic locations are primarily from the Bank's core markets of UK, West Africa and Lebanon. It is our intention to deliver a wider range of deposit products and other services during 2019.

## Treasury

The Bank's treasury function focuses on managing the balance sheet together with the market and liquidity risk of the Bank. The Bank does not undertake any proprietary trading activities. In accordance with regulatory requirements the Bank complies with and maintains an appropriate mix of assets for the purposes of liquidity in order to meet its Liquidity Coverage Ratio requirements as stipulated by the PRA.

The Bank manages its asset and liability maturity mismatches, liquidity positions and interest rate positions on an on-going basis and in accordance with defined limits and criteria set within its internal treasury and liquidity policies. These policies are reviewed on an annual basis and monitored by the Bank's Management Committee.

## Corporate Governance

The Bank places a strong emphasis on internal governance and the maintenance of high ethical standards in its working practices.

The Bank's corporate governance framework is driven by the Board which comprises two Executive Directors, three Non-Executive Directors representing the shareholder and three independent Non-Executive Directors (INEDs). The independent Non-Executive Directors have considerable commercial banking and regulatory experience gained at senior level from a cross section of internationally recognised financial institutions.

The Board has the collective responsibility of promoting the long-term success of the Bank. While the Executive Directors have the direct responsibility for business operations, the Non-Executive Directors are responsible for bringing independent judgement and scrutiny to decisions taken by the Board.

Responsibility for overseeing the risk framework of the Bank is devolved to the following Committees:

- Board Credit Committee
- Board Audit, Risk & Compliance Committee

# Strategic Report (continued)

## Corporate Governance (continued)

• Board Remuneration and Nomination Committee
• Management Committee (including ALCO)

The Bank has two independent control functions.

An independent Head of Risk & Compliance who holds the UK regulatory Senior Management Functions SMF4, SMF16 and SMF17 and who reports to the Board Audit, Risk & Compliance Committee (ARCC) and is responsible for the day-to-day evaluation and monitoring of the risks faced by the Bank and for submitting reports to the Bank and Board Committees.

Following a decision undertaken by the Board of Directors, the role of Internal Audit which covers Senior Management Function SMF5 has been outsourced entirely. The outsourcing partner has no executive role within the Bank and has been engaged to undertake and perform all internal audit services for the Bank effective from January 2019. The Head of Internal Audit service has a reporting line to both the Chairman of the ARCC who is in turn an Independent Non-Executive Director of the Board and the Bank's MD/CEO.

The control functions actively monitor developments and changes in the regulatory environment and reporting on such developments forms standing agenda items at the Board Committee meetings where the implications are considered and the Bank's response is approved.

## Risk Governance

The Bank engages a dedicated Risk Manager reporting to the Head of Risk & Compliance. The Risk Manager is certified by the Bank under the Senior Managers & Certification Regime (SMCR).Risk management within the Bank is a strategically important role ensuring the development and maintenance of the Bank's risk framework, its risk matrix and its risk appetite. The risk appetite defines the strategic approach of the bank and its business plans ensuring that its business strategy falls within the overall risk appetite and that the Bank incurs a level of risk that is individually and in aggregate acceptable to the Board.

The Bank follows the industry standard approach of "3 Lines of Defence" comprising:

• Operational controls as set out in functional and departmental procedures manuals (Level 1);
• Oversight, monitoring and periodic reporting by the Bank's control functions (Level 2); and
• Internal and external audit (Level 3).

The Board is responsible for ensuring the adequacy of the risk management systems of the Bank and for setting a clear statement of risk appetite and impact tolerances. It is assisted in this by a framework of committees, functions and control function managers. The Board has ultimate responsibility for setting the risk appetite of the Bank. Risk Appetite refers to the level of risk deemed acceptable to the Board in each of the principal risk categories i.e. Market Risk, Credit risk, Operational and Conduct Risk.

The role and responsibilities of the various risk management committees are set out in the following paragraphs.

**Audit, Risk & Compliance Committee**
The Board Audit, Risk & Compliance Committee ("ARCC") is responsible to the Board for the quality and effectiveness of the risk, compliance and audit functions of the bank and ensures that the key risks to which the Bank is exposed and the adequacy and effectiveness of the controls to manage these risks are kept under review. It ensures that adequate resources are made available at all times in order to meet the Bank's regulatory and statutory obligations and that the executive management has established and maintains an effective system of internal controls on behalf of the Board.

**Management Committee**
The Management Committee ("ManCo") is responsible for the efficient and controlled operation of the business. It is authorised to take all steps necessary to conduct the business of the Bank within the confines of the Board's approved strategy, budgets and mandates. It is accountable to the Board for designing, implementing and monitoring the process of risk management and implementing it into the day-to-day business activities of the Bank.

# Strategic Report (continued)

## Risk Governance (continued)

**Credit Committee**
The Board Credit Committee ("BCC") reviews all requests for lending in excess of the designated authority of the Management Committee and ensures compliance with relevant lending policies. It is also responsible for reviewing annually the Committees Terms of Reference, Bank's Credit and Large Exposure Policies and any Country limits as recommended by Management Committee.

**Remuneration & Nominations Committee**
The Board Remuneration and Nominations ("BRNC") combines two functions. For Remuneration it sets the over-arching principles and parameters of remuneration policy, determines the annual staff bonus pool and considers and approves the remuneration arrangements of the Chairman, the executive directors, and other senior managers. The role of the Nominations function is to support and advise the Board in ensuring it is comprised of individuals who are best able to discharge the duties and responsibilities of Directors ensuring that composition, diversity and succession are regularly assessed.

All senior management functions ensure that effective procedures for risk assessment are maintained, to identify the risks relating to the activities, processes and systems of the Bank and to recommend such amendments and changes as may be required from time to time to ensure the framework remains fit for purpose. The role of the control functions is to:

- recommend appropriate changes to risk governance & organisational structures;
- draft and implement policies and procedures in order to maintain compliance with the regulatory framework;
- provide periodic reports on risk positions and events to Bank and Board Committees; and
- perform on-going monitoring and on a regular basis assess the adequacy and effectiveness of the measures and procedures put in place, and the actions taken to address any deficiencies in, the Bank's compliance with its prudential obligations.

In order to assist the Bank's management in prioritising and focusing its risk management efforts, the control functions working with line managers maintain a "Risk Register" covering the principal risks faced by the business, which is reviewed annually or in response to material developments in the business environment.

## AML & Compliance

The Bank supports a strong compliance culture and maintains an independent compliance function, which is empowered to challenge business decisions. The Bank's compliance function is responsible for ensuring that adequate policies and procedures are in place to maintain the Bank's and its employees' compliance with its legal and regulatory obligations in respect of both AML and conduct of business issues. Such policies and procedures are designed to detect and minimize any risk of failure by the Bank to comply with its regulatory obligations, as well as any associated risks.

## Internal Audit

The primary role of Internal Audit is to help the Board and Executive Management to protect the assets, reputation and sustainability of the Bank. It does this by assessing whether all significant risks are identified and appropriately reported by management and the Risk function to the Board and Executive Management; assessing whether they are adequately controlled; and by challenging Executive Management to improve the effectiveness of governance, risk management and internal controls.

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve the Bank's operations. It assists the Bank in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the Bank's risk management, control, and governance processes. The role of Internal Audit at the Bank is now being outsourced.

As part of the Board's overall governance responsibility, ARCC is responsible for approving the Internal Audit Plan and budget. Following the Boards decision to outsource the role of Internal Audit, it remains satisfied that appropriate resources are in place.

# Strategic Report (continued)

## Risk Management

Given its current business activities, the Bank views its primary financial risks as being credit and operational. Liquidity and other market risks are considered of secondary magnitude due to the straightforward nature of the principal assets and modest overall transaction volumes conducted for short tenors.

The Bank has implemented a Board approved risk management framework which covers both the high-level governance matters referred to in the preceding section and the day-to-day identification and management of risks.

The control functions are responsible for maintaining a suite of risk management policies which give effect to the risk management framework and ensure compliance with the risk appetite set by the Board. On an annual basis the Bank undertakes a risk self-assessment programme which seeks to monitor developing risk trends and which supports the risk metrics produced through the Bank's management information systems.

The Bank's financial risks, conduct of business and other operational risks are managed through the Management Committee and the Credit Committee (BCC) within authorities set down by ARCC. The control functions are responsible for providing financial risk metrics to the Committees for monitoring and high level risk management. Conduct of business and operational risk metrics are also collated to assist the Bank in delivering a high quality customer centric outcome for customers whilst maintaining appropriate fraud and AML controls.

The Bank has also implemented a range of portfolio level limits in order to diversify its credit and liquidity risks.

Risk limits are monitored on a daily, weekly or monthly basis as appropriate to the nature of the underlying risks.

ICAAP, ILAAP and the overarching RRP statements are prepared and submitted to the Board of the Bank. These are developed as part of the annual planning and budgeting process to ensure that the Bank's strategy and business plans are achievable within its capital and liquidity resources. The ICAAP, ILAAP and RRP are all subject to interim review and update in response to material changes to the business or regulatory environments.

## Employees

The Bank has given considerable attention in selecting suitable employees to conduct its business operations and to meet the strategic objectives of the Bank. The Bank has a flat organisation structure but all departments are headed by persons with long experience in the industry in the relevant area.

By order of the Board

**Sophoklis Argyrou**
**Managing Director & CEO**

25 April 2019

# Directors´ Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2018. The financial statements have been prepared in accordance with the Companies Act 2006 and applicable accounting standards.

## Results and dividends

All profit for the year after taxation, which amounted to £5,565,723 (2017 - £7,425,953) was transferred to reserves. The directors do not recommend the payment of a dividend (2017 - £nil).

# Directors´ Report (continued)

## Subsequent events

Please refer to Note 32 for subsequent events.

## Going Concern

The directors have a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis in preparing the annual financial statements. Further details regarding the adoption of the going concern basis can be found within Note 3 of the significant accounting policies in the financial statements.

## Risk management objectives and policies

### Liquidity risk

The Bank manages its liquidity structure of assets, liabilities and commitments so that cash flows are appropriately balanced to ensure that all funding obligations are met when due and in accordance with the expectations of the PRA's liquidity regime. Banks are required to define a liquidity risk profile and appetite commensurate with their size and business policies. The Bank maintains adequate resources including a buffer of high quality liquid assets to meet regulatory stress requirements (LCR and in due course NSFR) and its own stress testing designed to ensure that even in the event of stressed events for certain periods, including those which are both firm specific and market wide, it is able to meet certain minimal criteria laid down within its policy.

The general policy of the Bank is to match to maturity so as far as is practicable within the guidelines and not to take on large exposures or placements that cannot easily be matched in the market as to currency or maturity. Liquidity is monitored on a daily basis by the Treasury, Risk and Senior Management teams and at each meeting of ALCO.

### Credit risk

The Bank's exposure to credit risk arises where there is a possibility of a counterparty defaulting on its obligations to the Bank. Credit risk exposure is controlled on a daily basis through close monitoring of client positions and is assessed with the aid of credit ratings. The credit department carries out day-to-day management of credit risk, while overall responsibility resides with the Bank's Board Credit Committee. The Bank will take collateral when required; this may be security over a customer's assets, or more commonly, cash.

Effective from 1 January 2018 the Bank has adopted the International Financial Reporting Standard IFRS9 changing the methodology and accounting treatment for the Bank's impairment provision requirements. In co-ordination with its parent, the Bank has introduced a bespoke solution in order to measure and calculate expected credit losses ("ECL") including an internal ratings system to supplement our risk based approach to risk allocation in order to meet the new standards.

### Operational risk

Operational risk arises from inadequate or failed internal processes, systems and personnel or from events external to the Bank. The Management Committee review and consider all operational risks to the Bank. Where operational risk has been identified, controls and procedures, including insurance cover have been put in place in mitigation against such risks. Regular reports are made to the senior management.

### Interest rate risk

Interest rate risk is the exposure of the Bank to adverse movements in interest rates. Changes in interest rates can affect the Bank's earnings by changing its net interest income. This risk mainly arises from mismatches between the interest bearing assets and liabilities on the balance sheet. Note 29 shows the interest rate sensitivity gap analysis for addressing the risk for the Bank as at 31 December 2018.

### Foreign exchange risk

Foreign exchange risk arises when market prices move and an open currency position has not been hedged. The Bank's policy is not to run speculative foreign exchange positions. The Bank enters into forward foreign currency exchange contracts to economically hedge the risk of changes in currency exchange rates. The Bank also offers foreign exchange services to all clients and select correspondents of the Bank. There are detailed limits and controls in place to monitor and limit the exposure. The Bank's policy is to clear its currency positions at the close of daily business.

# Directors´ Report (continued)

## Directors’ indemnities

The Bank has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

## Directors

The directors who served on the Board throughout the year were as follows:

Salim G Sfeir
Sophoklis Argyrou
Fawaz H Naboulsi
Marcus John S Trench
Anthony J Bush
Ramzi Saliba
Martin J Osborne
Antoun Samia

## Auditor

Each of the persons who are a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Bank’s auditor is unaware; and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Bank’s auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Deloitte LLP has expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board

**Sophoklis Argyrou**
**Managing Director & CEO**

25 April 2019

# Directors' responsibilities statement

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and of the profit or loss of the Bank for that period. In preparing these financial statements, the directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Bank's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Auditors Report to the members of Bank of Beirut (UK) Ltd

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE BANK OF BEIRUT (UK) LIMITED

### Report on the audit of the financial statements

### Opinion

**In our opinion the financial statements of the Bank of Beirut (UK) Limited (the 'Company'):**

- give a true and fair view of the state of the Company's affairs as at 31 December 2018 and of its profit for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:
- the Income statement;
- the Statement of other comprehensive income;
- the Balance sheet;
- the Statement of changes in equity;
- the Cash flow statement; and
- the related notes 1 to 32.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our

## Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)

### Basis for opinion (continued)

statements section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

| Summary of our audit approach | |
|---|---|
| **Key audit matters** | The key audit matters that we identified in the current year were:<br>• Loan impairment and provisioning; and<br>• Revenue recognition<br><br>Within this report, any new key audit matters are identified with « and any key audit matters which are the same as the prior year identified with» |
| **Materiality** | The materiality that we used in the current year was £950,000 which was determined on the basis of 1% of opening net assets. |
| **Scoping** | Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team. |
| **Significant changes in our approach** | In the current year we have changed the basis on which we determined materiality from one based on profits to one based on equity. We reassess the basis of materiality each year and having reviewed the operations of the Company we believe that equity is the most appropriate measure. We believe that the financial strength of the Company is a key consideration for the main users of the accounts, such as the financial regulator and the parent company, and hence we believe that the level of equity is the most appropriate basis on which to base materiality. |

### Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:
- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

*We have nothing to report in respect of these matters.*

### Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)

| Loan loss provisioning | |
|---|---|
| **Key audit matter description** | The Company has implemented the new IFRS 9 impairment standard in the financial statements for the year ended 31 December 2018. The total provision balance for December 2018 is £3.97m (Dec 17: £1.48m).<br><br>Specific provisions comprise the majority of the loan loss provisions held by the Company, being £2.47m of the total £3.97m provision balance as at December 2018 (December 17: £1.48m of total £1.48m). These constitute impaired loans within Stage 3.<br><br>There are a number of assumptions and judgements in respect of the allocation of assets to stage 1, 2 or 3 as well as in respect of the measurement expected credit losses (ECL). This includes the judgements involved in the determination of whether an asset has experienced a significant increase in credit risk.<br><br>In addition, there is judgement in the calculation of the level of provisioning against impaired loans in Stage 3.<br><br>The assumptions and judgements made by management involve a level of subjectivity and as a consequence we identify this area as a key audit matter in the financial statements.<br><br>Management disclose information about credit risk in the Directors' Report as well as in Note 29 on Financial Instruments and Risk Management |
| **How the scope of our audit responded to the key audit matter** | We completed the following procedures in relation to the loan impairment and provisioning balances:<br><br>• We obtained an understanding of management's lending and loan loss provisioning business cycles by undertaking a walk-through to identify the key controls and assessed the design and implementation of these key controls.<br><br>• We challenged each element of the new provisioning methodology and tested the appropriateness of the IFRS 9 provisioning policy against the requirements of the standard. This included consideration of the appropriateness of key assumptions used in the methodology.<br><br>• We tested the implementation of the IFRS methodology. As IFRS 9 was implemented at the beginning of the year, our audit procedures covered the opening balance on transition from IAS 39 as well as the ongoing measurement during the year.<br><br>• Our procedures included testing a sample of loans classified as Stage 1 and 2 in order to the assess the appropriateness of the staging classification. This included consideration of factors such as internal risk indicators and financial performance of the borrower in order to evaluate whether significant increases in credit risk and default events had been adequately captured.<br><br>• We tested a sample of Stage 3 impaired loans and assessed the judgements and calculations made in determining the level of provisions.<br><br>• We assessed the disclosures relating to provisions and adjustments made in the adoption of IFRS 9. |
| **Key observations** | We concluded that the provision balance was reasonable and in compliance with IFRS 9. |

# Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)

## Revenue recognition

| | |
|---|---|
| **Key audit matter description** | The specific risk of material misstatement identified is in relation to the validity and accuracy of fee and commission income booked. Fee and commission income amounts to £9.0m (2017: £10.2m) and is received from trade finance and loan arrangements and is a manual calculation, therefore there is potential for error and fraud through possible manipulation of this balance. We also note that given the short term nature of the majority of the Company's business, on materiality grounds, the Company has historically taken a number of simplifying assumptions to facilitate the booking of certain revenue types. There have been no changes to the Company's revenue recognition policy as a result of the introduction of IFRS15.<br>Management disclose information about revenue recognition in Notes 3 and 5 significant accounting policies in the financial statements. |
| **How the scope of our audit responded to the key audit matter** | In order to assess revenue recognition, we:<br>• obtained an understanding of management's revenue and trade finance business cycles by undertaking a walk-through to identify the key controls and assessed the design and implementation of these key controls; and<br>• performed sample testing on fee and commission income including recalculation of amounts and verification to supporting documents to assess whether the recognition is in line with accounting standards. Where simplifying assumptions have been used, we assessed the effect on the financial statements. |
| **Key observations** | Overall, we concluded that the fee and commission income balance was appropriate and free from material misstatement. We note that management, on materiality grounds, make certain simplifying assumptions to facilitate the booking of certain revenue types. We have concluded that this does not lead to a material misstatement. |

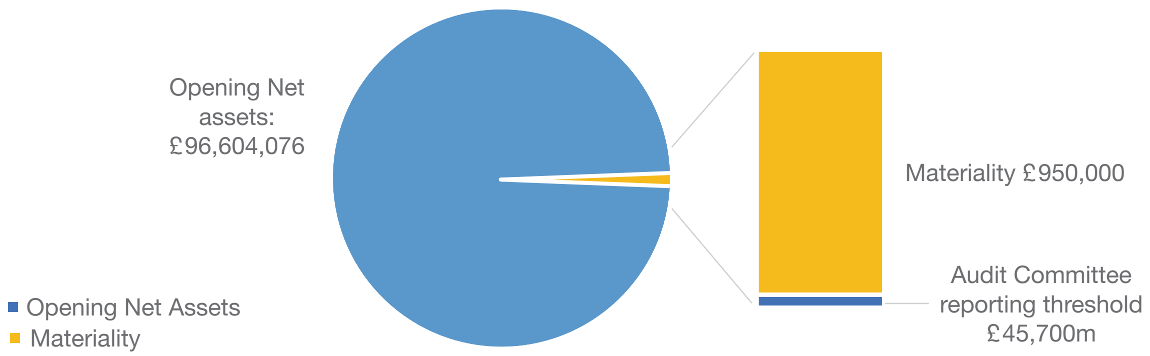
### Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

| | |
|---|---|
| **Materiality** | £950,000 (2017: £475,868) |
| **Basis for determining materiality** | Our audit materiality was determined as £950,000 based on 1% of opening net assets. |
| **Rationale for the benchmark applied** | Materiality has been based on opening net assets given our assessment of this being the most stable metric, and the most applicable to the operations of the Company. |

## Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)




We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £45,700 (2017: £23,793), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

### An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the Company and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

### Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

*We have nothing to report in respect of these matters.*

### Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

# Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)

## Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.
A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

## Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

### Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management and the audit committee, including obtaining and reviewing supporting documentation, concerning the Company's policies and procedures relating to:

    - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
    - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
    - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;

- involving internal specialists, including tax and IT;

- discussions among the engagement team regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: revenue recognition and loan loss provisioning.

- obtaining an understanding of the legal and regulatory frameworks that the Company operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the Company. The key laws and regulations we considered in this context included the UK Companies Act, pensions legislation, tax legislation and regulations from the Financial Conduct Authority and the Prudential Regulation Authority.

### Audit response to risks identified

As a result of performing the above, we identified revenue recognition and loan loss provisioning as key audit matters. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

# Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)

**Audit response to risks identified (contunued)**

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Prudential Regulatory Authority; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

**Audit response to risks identified (continued)**

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

### Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

### Matters on which we are required to report by exception

**Adequacy of explanations received and accounting records**
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

*We have nothing to report in respect of these matters.*

# Auditors Report to the members of Bank of Beirut (UK) Ltd (continued)

**Directors' remuneration**
Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

*We have nothing to report in respect of this matter.*

## Other matters

**Auditor tenure**
Following the recommendation of the audit committee, we were appointed by the board of directors of the Company on 10 December 2002 to audit the financial statements for the year ending 31 December 2002 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 17 years, covering the years ending 31 December 2002 to 31 December 2018.

**Consistency of the audit report with the additional report to the audit committee**
Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

**Use of our report**

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Alan Chaudhuri

Alan Chaudhuri
for and on behalf of Deloitte LLP
Senior Statutory Auditor
London, United Kingdom

25 April 2019

# Income Statement
## Year ended 31 December 2018

| | Notes | 2018<br>£ | 2017<br>£ |
|---|---|---|---|
| **Continuing operations** | | | |
| Interest receivable | 5 | 13,254,634 | 10,879,216 |
| Interest payable | 6 | (5,439,295) | (3,578,649) |
| | | | |
| **Net interest income** | | 7,815,339 | 7,300,567 |
| | | | |
| | | | |
| Net Fees and commissions receivable | | 9,009,354 | 10,178,921 |
| Foreign exchange income | | 467,461 | 538,696 |
| | | | |
| **Total non-interest income** | | 9,476,815 | 10,717,617 |
| | | | |
| **Total income** | | 17,292,154 | 18,018,184 |
| | | | |
| Administrative expenses | 7 | (9,472,412) | (8,149,095) |
| Net impairment on financial assets | 29 | (1,029,052) | (500,310) |
| | | | |
| **Profit before taxation** | 8 | 6,790,690 | 9,368,779 |
| Taxation | 9 | (1,224,967) | (1,942,826) |
| | | | |
| **Profit for the year** | | 5,565,723 | 7,425,953 |

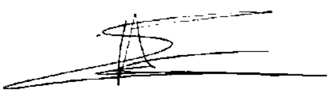
# Statement of other comprehensive Income
## Year ended 31 December 2018

| **Statement of Other Comprehensive Income** | Notes | 2018<br>£ | 2017<br>£ |
|---|---|---|---|
| **Profit for the year** | | 5,565,723 | 7,425,953 |
| | | | |
| **Items that may be reclassified subsequently to profit or loss:** | | | |
| | | | |
| Financial assets at fair value through other comprehensive income | | | |
| Profit arising during the year, net of tax | | 4,119 | (6,410) |
| | | | |
| Exchange difference on translating foreign operations, net of tax | | 25,261 | 34,433 |
| | | | |
| Income tax relating to items that may be reclassified | 9 | (783) | 1,234 |
| | | | |
| **Other Comprehensive income for the year net of tax** | | 28,597 | 29,257 |
| | | | |
| **Total Comprehensive income for the year** | | 5,594,320 | 7,455,210 |

# Balance sheet
## Year ended 31 December 2018

| | Notes | 2018<br>£ | 2017<br>£ |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at banks | | 180,059,533 | 105,686,182 |
| Placements with banks | 10 | 162,304,830 | 181,949,007 |
| Loans and advances to customers | 11 | 191,402,726 | 178,336,200 |
| Customers' acceptances | 12 | 9,843,804 | 8,425,491 |
| Held to maturity investments: | 13 | - | 3,014,495 |
| Debt securities at amortised cost | 13 | 1,585,826 | - |
| Available for sale financial assets | 14 | - | 25,910,526 |
| Financial assets at FVTOCI | 14 | 40,683,260 | - |
| Derivative assets | 29 | - | 20,731 |
| Prepayments and accrued income | | 805,423 | 818,178 |
| Land and Buildings | 15 | 19,068,117 | 15,266,954 |
| Property and equipment | 15 | 967,527 | 365,596 |
| Intangible assets | 16 | 445,848 | 229,200 |
| Deferred tax asset | 21 | 63,961 | - |
| Goodwill | 17 | 751,540 | 751,540 |
| | | | |
| **Total Assets** | | 607,982,395 | 520,774,100 |
| | | | |
| **Liabilities** | | | |
| Deposits by banks | 18 | 357,332,819 | 306,972,422 |
| Customer accounts | 19 | 104,592,475 | 92,396,543 |
| Acceptances payable | 12 | 9,914,706 | 8,425,491 |
| Derivative liabilities | 29 | - | 16,090 |
| Accruals and deferred income | | 449,396 | 312,098 |
| Other liabilities | 20 | 1,694,689 | 12,718 |
| Provision for liabilities and charges | | 95,000 | 155,000 |
| Current Tax liabilities | | 549,349 | 1,014,433 |
| Deferred tax liability | 21 | - | 38,524 |
| Subordinated loan | 22 | 32,539,176 | 14,826,705 |
| | | | |
| **Total liabilities** | | 507,167,610 | 424,170,024 |
| | | | |
| **Equity** | | | |
| Called up share capital | 23 | 34,150,000 | 34,150,000 |
| Retained earnings | 24 | 66,664,785 | 62,454,076 |
| | | | |
| **Total equity** | | 100,814,785 | 96,604,076 |
| | | | |
| **Total liabilities and equity** | | 607,982,395 | 520,774,100 |

These financial statements were approved by the board of directors and authorised for issue on 25 April 2019. They were signed on its behalf by:



**S Argyrou**
**Managing Director & CEO**
25 April 2019

# Statement of changes in equity
# Year ended 31 December 2018

| | Called up share capital £ | Retained earnings £ | Total £ |
|---|---|---|---|
| As at 1 January 2017 | 34,150,000 | 54,998,866 | 89,148,866 |
| Profit for the period | - | 7,425,953 | 7,425,953 |
| Other comprehensive income for the period | - | 29,257 | 29,257 |
| | | | |
| As at 31 December 2017 | 34,150,000 | 62,454,076 | 96,604,076 |

| | Called up share capital £ | Retained earnings £ | Total £ |
|---|---|---|---|
| As at 1 January 2018 | 34,150,000 | 62,454,076 | 96,604,076 |
| Adjustment on adoption of IFRS9 | - | (1,383,611) | (1,383,611) |
| Profit for the period | - | 5,565,723 | 5,565,723 |
| Other comprehensive income for the period | - | 28,597 | 28,597 |
| | | | |
| As at 31 December 2018 | 34,150,000 | 66,664,785 | 100,814,785 |

# Cash flow statement
## Year ended 31 December 2018

| | Notes | 2018<br>£ | 2017<br>£ |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before taxation | | 6,790,690 | 9,368,779 |
| | | | |
| Adjustment for: | | | |
| Increase in depreciation | 15 | 617,428 | 334,468 |
| Increase in net impairment losses on loans and advances to customers | 11 | 1,029,052 | 404,543 |
| | | | |
| Operating cash flows before movements in working capital | | 8,437,170 | 10,107,790 |
| | | | |
| Decrease in prepayments and accrued income | | 12,755 | (329,075) |
| Increase in accruals and deferred income | | 137,298 | 24,760 |
| Net decrease in loans and advances to banks and customers | | 6,577,650 | (22,534,338) |
| Decrease in provisions for liabilities and charges | | (60,000) | 155,000 |
| Increase in deposits by banks and customers | | 62,556,329 | 42,057,465 |
| Increase in other liabilities | | 1,681,971 | (203,474) |
| Net decrease in derivative financial instruments | | - | (5,867) |
| | | - | |
| Cash generated from operations | | 79,343,174 | 29,272,261 |
| | | | |
| Corporation tax paid | | (1,441,300) | (1,781,625) |
| Corporation tax refund | | - | - |
| | | | |
| Net cash generated by operating activities | | 77,901,874 | 27,490,636 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of equipment and intangible assets | | (865,087) | (484,237) |
| Purchase of land and building | | (3,923,544) | (15,297,529) |
| Proceeds on maturity of treasury bills and other eligible bills | | 169,220,123 | 52,617,376 |
| Purchase of treasury bills and other eligible bills | | (183,341,643) | (53,926,063) |
| | | | |
| Net cash (used in) / generated from investing activities | | (18,910,151) | (17,090,453) |
| | | | |
| **Cash flows from financing activities** | | | |
| Subordinated borrowing | | 16,000,000 | - |
| | | | |
| **Net increase in cash and cash equivalents** | | 74,991,723 | 10,400,183 |
| | | | |
| **Cash and cash equivalents at the beginning of the year** | | 105,686,182 | 96,052,314 |
| Effect of exchange rate changes on cash and cash equivalents | | (618,372) | (766,315) |
| | | | |
| **Cash and cash equivalents at the end of the year** | | 180,059,533 | 105,686,182 |
| | | | |
| Cash and cash equivalents comprised of: | | | |
| | | | |
| Cash and balances at banks | | 180,059,533 | 105,686,182 |

# Notes to the financial statements
# Year ended 31 December 2018

## 1. General information

Bank of Beirut (UK) Ltd ("the Bank") is a company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 5. The nature of the Bank's operations and its principal activities are set out in the Strategic Report on pages 8 to 13 and the Directors' Report on pages 13 to 15.
These financial statements are presented in pounds sterling being the currency of the primary economic environment in which the Bank operates.

## 2. Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (IASB) as adopted by the European Union.

The financial statements have been prepared on the historical cost basis as modified by financial instruments recognised at fair value through other comprehensive income and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. Historical cost is generally based on the fair value of the consideration given in exchange for the assets. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Bank takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis. In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability

### Adoption of new and revised standards

### New and amended IFRS Standards effective for the current year

The Bank has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018.

(i) IFRS 9 Financial Instruments:
IFRS 9 replaces IAS 39 and addresses classification, measurement and derecognition of financial assets and liabilities, the impairment of financial assets measured at amortised cost or fair value through other comprehensive income, expected credit loss provisions for loan commitments and financial guarantee contracts and general hedge accounting.

*Impairment*: IFRS 9 replaces the IAS 39 'incurred loss' impairment approach with an 'expected credit loss' approach. The revised approach applies to financial assets including finance lease receivables, recorded at amortised cost or fair value through other comprehensive income; loan commitments and financial guarantees that are not measured at fair value through profit or loss are also in scope. The expected credit loss approach requires an allowance to be established upon initial recognition of an asset reflecting the level of losses anticipated after having regard to, amongst other things, expected future economic conditions. Subsequently the amount of the allowance is affected by changes in the expectations of loss driven by changes in associated credit risk.

# Notes to the financial statements (continued)
# Year ended 31 December 2018

## Basis of preparation (continued)

*Classification and measurement*: IFRS 9 requires financial assets to be classified into one of the following measurement categories: fair value through profit or loss, fair value through other comprehensive income or amortised cost. Classification is made on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The Bank has reclassified the following captions:

| | Balance per IAS 39 | Reclassification | Adoption of IFRS 9 | Balance per IFRS 9 |
|---|---|---|---|---|
| | 31-Dec-17 | | | 01-Jan-18 |
| | £ | £ | £ | £ |
| Held to maturity investments | 3,014,495 | (3,014,495) | | - |
| Debt Securities at amortised cost | | 3,014,495 | | 3,014,495 |
| Available for sale Treasury Bills | 25,910,526 | (25,910,526) | | - |
| Financial Assets at FVTOCI | | 25,910,526 | | 25,910,526 |
| Provisions for impairment | 1,477,209 | | 1,383,612 | 2,860,821 |
| Reserves and retained earnings | 62,454,076 | | (1,383,611) | 61,070,465 |

The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income.

*General hedge accounting*: The new hedge accounting model aims to provide a better link between risk management strategy, the rationale for hedging and the impact of hedging on the financial statements. The standard does not explicitly address macro hedge accounting solutions, which are being considered in a separate IASB project – Accounting for Dynamic Risk Management. Until this project is finalised, the IASB has provided an accounting policy choice to retain IAS 39 hedge accounting in its entirety or choose to apply the IFRS 9 hedge accounting requirements. The Bank has elected to apply IAS 39 hedge accounting in the event that such transactions arise.

(ii) IFRS 15 Revenue from Contracts with Customers

IFRS 15 has replaced IAS 18 Revenue and IAS 11 Construction Contracts. The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. The recognition of such revenue is in accordance with five steps to: identify the contract; identify the performance obligations; determine the transaction price; allocate the transaction price to the performance obligations; and recognise revenue when the performance obligations are satisfied. (Please see Significant Accounting policies No. 3)

In the current year, the Bank has applied a number of amendments to IFRS Standards and Interpretations issued by the International Accounting Standards Board (IASB) that are effective for an annual period that begins on or after 1 January 2018. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

IFRS 2 (amendments) Classification and Measurement of Share based Payment Transactions

IAS 40 (amendments) Transfers of Investment Property

Annual Improvements to IFRS Standards 2014 – 2016 Cycle: Amendments to IAS 28 Investments in Associates and Joint Ventures

IFRIC 22 Foreign Currency Transactions and Advance Consideration

# Notes to the financial statements (continued)
# Year ended 31 December 2018

## Basis of preparation (continued)

### New and revised IFRS Standards in issue but not yet effective

At the date of authorisation of these financial statements, the Bank has not applied the following new and revised IFRS Standards that have been issued but are not yet effective and, in some cases, had not yet been adopted by the EU:

| | |
|---|---|
| **IFRS 16** | Leases |
| **IFRS 17** | Insurance Contracts |
| **Amendments to IFRS 9** | Prepayment Features with Negative Compensation |
| **Amendments to IAS 28** | Long term Interests in Associates and Joint Ventures |
| **Annual Improvements to IFRS Standards 2015–2017 Cycle** | Amendments to IFRS 3 Business Combinations, IFRS 11 Joint Arrangements, IAS 12 Income Taxes and IAS 23 Borrowing Costs |
| **Amendments to IAS 19 Employee Benefits** | Plan Amendment, Curtailment or Settlement |
| **IFRS 10 Consolidated Financial Statements and IAS 28 (amendments)** | Sale or Contribution of Assets between an Investor and its Associ-ate or Joint Venture |
| **IFRIC 23** | Uncertainty over Income Tax Treatments |

The directors do not expect that the adoption of the Standards listed above will have a material impact on the financial statements of the Bank in future periods.

# Notes to the financial statements (continued)
# Year ended 31 December 2018

## 3. Significant accounting policies

The principal accounting policies adopted are set out below.

**Going concern basis**
The Bank's business activities, together with factors likely to affect its future development, performance and financial position and commentary on the Bank's financial results, its cash flows and liquidity requirements are set out in the Strategic Report on pages 8 to 13 and the Directors' report on pages 13 to 15 and elsewhere within the financial statements. In addition notes 29 and 30 to the financial statements include the Bank's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities, and its exposures to liquidity risk and credit risk. The Bank has a proven and conservative business model and its performance has been resilient notwithstanding some difficult trading conditions experienced in recent years. The directors further believe the Bank has a sound funding and liquidity position and adequate capital resources. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements.

After making due enquiries, the Board has a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future and for this reason, the going concern basis continues to be adopted in preparing the financial statements.

**Goodwill**
Goodwill on the acquisition is recognised as an asset and initially measured at cost, being the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the net assets over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities.

Goodwill is not amortised but is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to the cash-generating unit expected to benefit from the synergies of the combination. Since the acquisition, the business has been integrated into the wider business of the Bank which is considered to be the cash generating unit for goodwill impairment testing. Goodwill is tested for impairment annually, or more frequently when there is an indication that the unit may be impaired.

**Revenue recognition**

**Net interest income**
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest method, except for those classified at fair value through profit or loss. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument to the gross carrying amount of the financial asset (before adjusting for expected credit losses) or to the amortised cost of the financial liability including items that are an integral part of the overall return. Interest income from non-credit impaired financial assets is recognised by applying the effective interest rate to the gross carrying amount of the asset; for credit impaired financial assets, the effective interest rate is applied to the net carrying amount after deducting the allowance for expected credit losses.

**Fee and commission income and expense**
Fees and commissions receivable which are not an integral part of the effective interest rate are recognised as income as the Bank fulfils its performance obligations. The Bank's principal performance obligations arising from contracts with customers are in respect of current and loan accounts. These fees are received, and the Bank provides the service, monthly; the fees are recognised in income on this basis. The Bank also receives certain fees in respect of its trade finance business where the performance obligations are typically fulfilled towards the end of the customer contract; these fees are recognised in income on this basis. Where it is unlikely that the loan commitments will be drawn, loan commitment fees are recognised in fee and commission income over the life of the facility, rather than as an adjustment to the effective interest rate for loans expected to be drawn.

# Notes to the financial statements (continued)
# Year ended 31 December 2018

## 3. Significant accounting policies (continued)

Incremental costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

**Leasing**
Rentals paid under operating leases are charged to income on a straight-line basis over the lease term.

**Derivative financial instruments and hedge accounting**
As permitted by IFRS 9, the Bank applies the requirements of IAS 39 to its hedging relationships as and when they arise. All derivatives are recognised at their fair value. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of all derivative instruments are recognised immediately in the income statement.

**Financial assets and liabilities**
On initial recognition, financial assets are classified as measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the Bank's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest.

The Bank assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. The Bank reclassifies financial assets when and only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Bank's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare. The Bank initially recognises loans and advances, deposits, debt securities in issue and subordinated liabilities when the Bank becomes a party to the contractual provisions of the instrument. Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expired.

*Financial instruments measured at amortised cost* - Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Financial assets measured at amortised cost are predominantly loans and advances to customers and banks together with certain debt securities. Loans and advances are initially recognised when cash is advanced to the borrower at fair value inclusive of transaction costs. Interest income is accounted for using the effective interest method. Financial liabilities are measured at amortised cost.

*Financial assets measured at fair value through other comprehensive income* -Financial assets that are held to collect contractual cash flows and for subsequent sale, where the assets' cash flows represent solely payments of principal and interest, are recognised in the balance sheet at their fair value, inclusive of transaction costs. Interest calculated using the effective interest method and foreign exchange gains and losses on assets denominated in foreign currencies are recognised in the income statement. All other gains and losses arising from changes in fair value are recognised directly in other comprehensive income, until the financial asset is either sold or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement other than in respect of equity shares, for which the cumulative revaluation amount is transferred directly to retained profits. The Bank recognises a charge for expected credit losses in the income statement. As the asset is measured at fair value, the charge does not adjust the carrying value of the asset; it is reflected in other comprehensive income.

*Financial assets measured at fair value through profit and loss*- The Bank does not have any assets that are designated at fair value.

*Borrowings*- Borrowings which include deposits from banks, customer deposits and subordinated liabilities are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

# Notes to the financial statements
# Year ended 31 December 2018

## 3. Significant accounting policies (continued)

### Impairment of financial assets

The impairment charge in the income statement includes the change in expected credit losses. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts.

Expected credit losses are calculated as an unbiased and probability weighted estimate using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Bank at the point of default after taking into account the value of any collateral held, repayments, or other mitigants of loss and including the impact of discounting using the effective interest rate.

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk since origination, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses).

Financial assets where 12 month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk since initial recognition are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3. Stage 3 assets are subject to individual rather than collective assessment. Such cases are subject to a risk-based impairment sanctioning process, and these are reviewed and updated at least quarterly, or more frequently if there is a significant change in the credit profile.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Bank uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings together with qualitative indicators such as watch lists and other indicators of historical delinquency, credit weakness or financial difficulty.

Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since origination, the asset is transferred back to Stage 1. Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. Default is considered to have occurred when there is evidence that the customer is experiencing financial difficulty which is likely to affect significantly the ability to repay the amount due.

IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Bank has rebutted this presumption. As a general rule, where the Bank is in a Trade Finance relationship and one or a small number of individual items which form part of a larger portfolio are past due, specifically where these relate to claims or charges, but the remaining exposures are performing, the Bank will determine on a case by case basis that there has not been a material deterioration in credit risk. In certain circumstances, the Bank will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until the credit risk has improved such that it no longer represents a significant increase since origination (for a return to Stage 1), or the loan is no longer credit impaired (for a return to Stage 2).

Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value. All changes in lifetime expected credit losses subsequent to the assets' initial recognition are recognised as an impairment charge.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement. For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes has been completed, or the status of the account reaches a point where policy dictates

# Notes to the financial statements
# Year ended 31 December 2018

## 3. Significant accounting policies (continued)

**Impairment of financial assets (continued)**
that continuing attempts to recover are no longer appropriate. For commercial lending, a write-off occurs if the loan facility with the customer is restructured, the asset is under administration and the only monies that can be received are the amounts estimated by the administrator, the underlying assets are disposed and a decision is made that no further settlement monies will be received, or external evidence (for example, third party valuations) is available that there has been an irreversible decline in expected cash flows.

**Financial liabilities and equity**
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

All financial liabilities are held at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

**Derivative financial instruments**
The Bank's activities expose it primarily to the financial risks of changes in currency exchange rates. The Bank uses foreign exchange forward contracts to economically hedge these exposures as and when they arise. The Bank does not use derivative financial instruments for speculative purposes.

The use of financial derivatives is governed by the Bank's policies approved by the board of directors, which provide written principles on the use of financial derivatives.

The Bank does not apply hedge accounting to its derivative financial instruments.

Derivative financial instruments are initially recognised at fair value at the date a derivative contract is entered into, and subsequently measured, at fair value.

**Cash and balances at banks**
Cash and cash equivalents comprise cash on hand and at Banks, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

**Property and equipment**
Property and equipment are stated in the balance sheet at cost, less accumulated depreciation and accumulated impairment losses. With the exception of freehold Land, depreciation is charged on all property and equipment, at rates calculated to write off the cost, less estimated residual value, of each property and equipment evenly over its expected useful life using the straight-line method on the following bases:

| | |
|---|---|
| Leasehold improvements | over the lease term |
| Land and Buildings | 2% to 5% for the building only |
| Fixtures, fittings and equipment | 10% to 33.33% |

The gain or loss arising on the disposal or retirement of a property and equipment is determined as the difference between the sales proceeds and the carrying amount of the property and equipment and is recognised in income.

Differences arising from property and equipment held with our Frankfurt Branch in Euros are shown as translation differences.

At each balance sheet date, the Bank reviews the carrying amounts of property and equipment to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists,

The recoverable amount of the property and equipment is estimated in order to determine the extent of the impairment loss (if any).

# Notes to the financial statements
# Year ended 31 December 2018

## 3. Significant accounting policies (continued)

**Intangible assets acquired separately**
Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

**Derecognition of intangible assets**
An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognised in profit or loss when the asset is derecognised.

**Impairment of tangible and intangible assets excluding goodwill**
At each balance sheet date, the Bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

An intangible asset with an indefinite useful life is tested for impairment at least annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a re-valued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a re-valued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**Taxation**
Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of the assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit and are accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and

# Notes to the financial statements
# Year ended 31 December 2018

## 3. Significant accounting policies (continued)

**Taxation (continued)**
deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Bank intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax are recognised as an expense or income in profit or loss, except when they relate to items credited or debited directly to equity, in which case the tax is also recognised directly in equity.

**Pension Schemes**
The Bank contributes to a defined contribution scheme which is open to all members of staff over the age of 18. Contributions are charged to the income statement when they become payable in accordance with the scheme.

**Foreign currency translation**
Transactions in foreign currencies are recorded at the rate of exchange ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rates of exchange ruling on the balance sheet date. All differences arising are taken to the income statement. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains or losses are recognised directly to equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly to equity.

**Offsetting of assets and liabilities**
All assets and liabilities have been reported gross unless there is a legally enforceable right to offset and there is intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

## 4. Critical accounting judgements and estimates and key sources of estimation uncertainty

In the process of applying the Bank's accounting policies, which are described in note 3, management has made the following judgements and estimates that have the most significant effect on the amounts recognised in the financial statements. The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

**Allowance for impairment losses**
At 31 December 2018 the Bank's expected credit loss allowance was £2.472 million (1 January 2018: £1.477 million). The calculation of the Bank's expected credit loss (ECL) allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Bank to make a number of judgements, assumptions and estimates. The most significant are set out below.

# Notes to the financial statements
# Year ended 31 December 2018

## 4. Critical accounting judgements and estimates and key sources of estimation uncertainty (continued)

**Definition of default and credit impaired assets**
The probability of default (PD) of an exposure, both over a 12 month period and over its lifetime, is a key input to the measurement of the ECL allowance. Determination of the PD is based on a consistent model applied against the key sectors to which the bank has exposure using external rating models with adjustments made to account for the shorter dated maturities. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The definition of default adopted by the Bank is described above under caption 'Impairment of financial assets'.

**Significant increase in credit risk**
Performing assets are classified as either Stage 1 or Stage 2. An ECL allowance equivalent to 12 months expected losses is established against assets in Stage 1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk (SICR) since initial recognition.

The Bank uses a quantitative test together with qualitative indicators to determine whether there has been a SICR for an asset. The setting of precise trigger points combined with risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance. The Bank monitors the effectiveness of SICR criteria on an ongoing basis.

The Bank uses forward looking information such as changes in outstanding balances, macro-economic overlays, together with migration and seasoning factors in order to determine and build scenario based ECL estimates.

In order to derive Loss Given Default (LGD) percentages, four Business Segments have been defined, namely Sovereign, Corporate, Bank and Trade Finance. Given low absolute client numbers and in the absence of sufficient historic loss data, the calculations use a variety of international benchmark data including those defined by the Basel Committee, the International Chamber of Commerce and other relevant studies. The Bank only recognises cash and property (subject to haircuts) as acceptable forms of security to arrive at final LGD estimates.

## 5. Interest receivable

Interest receivable comprises interest from:

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Loans and receivables: | 7,964,188 | 6,375,343 |
| Loans and advances to banks | 4,602,505 | 4,333,565 |
| | | |
| Held to maturity investments | - | 170,308 |
| Debt securities at amortised cost | 155,504 | - |
| Financial assets at FVOCI | 532,437 | - |
| | | |
| | **13,254,634** | **10,879,216** |

The amount of interest receivable attributable to group companies is £369,652 (2017: £167,345).

## 6. Interest payable

Interest payable comprises interest to:

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Deposit by banks | 1,460,391 | 1,005,459 |
| Customers' accounts | 1,058,734 | 754,965 |
| Group companies | 2,920,170 | 1,818,225 |
| | | |
| | 5,439,295 | 3,578,649 |

# Notes to the financial statements
# Year ended 31 December 2018

## 7. Administrative expenses

| Administrative expenses include: | 2018 £ | 2017 £ |
|---|---|---|
| Staff costs during the year (including directors): | | |
| Wages and salaries | 4,224,751 | 3,993,973 |
| Social security costs | 487,264 | 427,504 |
| Other staff costs | 348,404 | 301,192 |
| | 5,060,419 | 4,722,669 |
| | | |
| Pension costs | 269,627 | 250,001 |
| Total staff costs | 5,330,046 | 4,972,670 |
| | | |
| Occupancy costs | 1,138,476 | 1,053,987 |
| Administrative costs | 2,386,462 | 1,787,969 |
| Depreciation | 617,428 | 334,469 |
| | | |
| Total administrative expenses | **9,472,412** | **8,149,095** |

The average monthly number of employees during the current and prior year was as follows:

| | 2018 No. | 2017 No. |
|---|---|---|
| Commercial and retail banking activities | 65 | 58 |

| **Directors' emoluments**<br>Directors' remuneration during the year consists of: | 2018 £ | 2017 £ |
|---|---|---|
| Salaries and other emoluments | 777,317 | 702,064 |
| Pension costs | 40,838 | 49,853 |
| | | |
| | 818,155 | 751,917 |

The emoluments of the highest paid director for the year ended 31 December 2018 were £466,307 (2017 - £394,724).

The highest paid director is a member of the Bank's pension scheme.

There were two directors (2017 - two directors) who were part of the Bank's pension scheme.

## 8. Profit before taxation

| The profit is stated after (crediting) / charging: | 2018 £ | 2017 £ |
|---|---|---|
| Net foreign currency gains | (467,461) | (538,696) |
| Auditor's remuneration | | |
| Audit services | 98,000 | 90,000 |
| Non-audit services | 30,000 | 10,953 |
| Operating lease rentals – Land and buildings | 482,293 | 471,437 |
| Depreciation | 617,428 | 334,469 |

# Notes to the financial statements
# Year ended 31 December 2018

| The analysis of non-audit services is as follows: | 2018 £ | 2017 £ |
|---|---|---|
| Company Secretarial services | - | 6,953 |
| SCV health check services | - | 4,000 |
| Professional Services | 30,000 | - |
| | | |
| Total non-audit fees | 30,000 | 10,953 |

## 9. Taxation

The charge for the year can be reconciled to the profit per the income statement as follows:

| Analysis of tax charge for the year | 2018 £ | 2017 £ |
|---|---|---|
| Current year | 1,238,915 | 1,827,365 |
| Double tax relief | (75,802) | (172,630) |
| Prior year adjustment | 2,090 | (11,600) |
| | | |
| Total Current tax charge | 1,165,203 | 1,643,135 |
| Overseas tax | 162,249 | 299,912 |
| Deferred tax – current year | (102,485) | (221) |
| | | |
| Total tax expense | 1,224,967 | 1,942,826 |

The charge for tax is based upon a UK corporation tax rate of 19% from 1 January 2018 to 31 December 2018.

Finance Act 2016 enacted reductions in the UK corporation tax rate to 17% with effect from 1 April 2020. This reduction in the tax rate will impact the current tax charge in future periods.

| Factors affecting the tax charge for the year | 2018 £ | 2017 £ |
|---|---|---|
| Profit before taxation | 6,790,690 | 9,368,779 |
| Tax charge at average UK Corporation tax rate of 19% (2017: – 19.24668%) | 1,290,231 | 1,803,179 |
| Effects of: | | |
| Fixed asset differences | 96,446 | 12,321 |
| Expenses not deductible for tax purposes | (201) | 12,949 |
| Provision adjustment | (262,643) | - |
| OCI taxable credit | 783 | (1,234) |
| Adjustments to prior periods | 2,090 | (11,717) |
| Foreign tax credits not used | 86,447 | 127,282 |
| Adjust opening and closing deferred tax to average rate 19% | 12,032 | 46 |
| Deferred tax not recognised | (218) | - |
| | | |
| Tax expense for the year | 1,224,967 | 1,942,826 |

In addition to the amount charged to the Income Statement, the following amounts relating to tax have been recognised in Other Comprehensive Income:

| Items that may be reclassified subsequently to profit or loss: | 2018 £ | 2017 £ |
|---|---|---|
| Financial assets at FVTOCI | | |
| Gains/(Losses) arising during the year | 4,119 | (6,410) |
| | | |
| Exchange difference on translating foreign operations | 25,261 | 34,433 |
| | | |
| Total income tax recognised in other comprehensive income | (783) | 1,234 |

# Notes to the financial statements
# Year ended 31 December 2017

## 10. Placements with banks

| | 2018 £ | 2017 £ |
|---|---|---|
| Remaining maturity | | |
| Three months or less excluding on demand | 162,304,830 | 181,949,007 |

There are no amounts in respect of group companies included in placements with banks in either the current or prior year. ECL's are included in these balances as per IFRS9. The ECL amount as at 31 December 2018 was £356 for placements.

## 11. Loans and advances to customers

| | 2018 £ | 2017 £ |
|---|---|---|
| Repayable: | | |
| On demand or at short notice | 25,676,329 | 19,251,160 |
| Remaining maturity: | | |
| Three months or less excluding on demand | 121,038,770 | 106,513,386 |
| One year or less but over three months | 17,841,667 | 16,806,279 |
| Three years or less but over one year | 27,755,621 | 33,479,843 |
| Five years or less but over three years | 2,966,507 | 3,147,519 |
| Over five years | - | 615,222 |
| | | |
| | 195,278,894 | 179,813,409 |
| Impairment losses | (3,876,168) | (1,477,209) |
| | | |
| | 191,402,726 | 178,336,200 |

## 12. Customers' acceptances and acceptances payable

Customers' acceptances and acceptances payable relate to letters of credit where all required documentation has been received and certified by the Bank which make up a total of £9,843,804 and includes an ECL amount of £70,902. Upon completion of the required documentation, the Bank is obliged to make payment to the counterparty of the customer and the same amount is recoverable from the customer. The customers' acceptances are due from the customers while the acceptances payable are due to the counterparty of the customer. Upon acceptance of presented documents, the Bank reserves the right, subject to its customer's request, whether to discount such commitments. For clarification discounted acceptances are excluded from the total of Contingent liabilities referred to under Note 25.

# Notes to the financial statements
# Year ended 31 December 2018

## 13. Debt securities at amortised cost

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Book Value £ | Market Value £ | Book Value £ | Market Value £ |
| Lebanese Treasury Bills | 1,585,826 | 1,472,891 | 3,014,495 | 2,989,587 |
| | | | | |
| | 1,585,826 | 1,472,891 | 3,014,495 | 2,989,587 |

The treasury bills are classified as stage 1 and include an ECL of £18,317. The movements during the year are summarised as follows:

| | 2018 £ | 2017 £ |
|---|---|---|
| Balance as at 1 January | 3,014,495 | 3,301,300 |
| Acquisitions | 10,393 | 14,818 |
| Maturities | (1,608,671) | - |
| Exchange differences on monetary assets | 169,609 | (301,623) |
| | | |
| Balance as at 31 December | 1,585,826 | 3,014,495 |

| | 2018 £ | 2017 £ |
|---|---|---|
| Remaining maturity: | | |
| Three months or less excluding on demand | - | - |
| One year or less but over three months | 773,326 | 1,506,177 |
| Three years or less but over one year | 812,500 | 739,372 |
| Five years or less but over three years | - | 768,946 |
| Five years or more | - | - |
| | | |
| | 1,585,826 | 3,014,495 |

## 14. Financial assets at fair value through other comprehensive income

The UK and US treasury bills are classified as 'Financial assets at fair value through other comprehensive income' as they are purchased for holding as Liquid Asset Buffer and are categorised as Stage 1. These assets were previously classified and held as 'Available for sale'.

The movements during the year are summarised as follows:

| **UK Treasury Bills** | 2018 £ | 2017 £ |
|---|---|---|
| Balance as at 1 January | 5,992,640 | 17,993,240 |
| Acquisitions | 20,050,000 | 14,000,000 |
| Maturities | (18,041,723) | (25,993,240) |
| Discount received | (8,534) | (8,277) |
| Sales | - | - |
| Movement in fair value | (653) | 917 |
| | | |
| Balance as at 31 December | **7,991,730** | **5,992,640** |

| | 2018 £ | 2017 £ |
|---|---|---|
| Balance as at 1 January | 19,917,886 | 7,282,841 |
| Exchange differences on monetary assets | 1,130,719 | (628,498) |
| Acquisitions | 163,281,250 | 39,926,063 |
| Maturities | (149,569,730) | (26,617,375) |
| Discount received | (120,263) | (39,645) |
| Sales | (1,953,125) | - |
| Movement in fair value | 4,793 | (5,500) |
| | | |
| Balance as at 31 December | **32,691,530** | **19,917,886** |

# Notes to the financial statements
# Year ended 31 December 2018

## 15. Property and equipment

| | Leasehold improvements £ | Fixtures, fittings and equipment £ | Land and Buildings £ | Total £ |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 January 2017 | 480,492 | 741,482 | - | 1,221,974 |
| Additions | 31,836 | 220,933 | 15,297,529 | 15,550,298 |
| Disposals | (3,390) | (22,293) | - | (25,683) |
| Translation difference | 166 | 7,767 | - | 7,933 |
| | | | | |
| At 31 December 2017 | 509,104 | 947,889 | 15,297,529 | 16,754,522 |
| | | | | |
| Additions | - | 865,087 | 3,923,544 | 4,788,631 |
| Disposal | - | - | - | - |
| Translation difference | 58 | 2,818 | - | 2,876 |
| | | | | |
| At 31 December 2018 | 509,162 | 1,815,794 | 19,221,073 | 21,546,029 |
| | | | | |
| **Depreciation** | | | | |
| At 1 January 2017 | 378,072 | 557,353 | - | 935,425 |
| Charge for the year | 63,914 | 110,969 | 30,575 | 205,458 |
| Disposals | (3,390) | (22,293) | - | (25,683) |
| Translation difference | 166 | 6,606 | - | 6,772 |
| | | | | |
| At 31 December 2017 | 438,762 | 652,635 | 30,575 | 1,121,972 |
| | | | | |
| Charge for the year | 70,313 | 193,081 | 122,381 | 385,775 |
| Disposal | - | - | - | - |
| Translation difference | 58 | 2,580 | - | 2,638 |
| | | | | |
| At 31 December 2018 | 509,133 | 848,296 | 152,956 | 1,510,385 |
| | | | | |
| **Net book value** | | | | |
| At 31 December 2018 | 29 | 967,498 | 19,068,117 | 20,035,644 |
| | | | | |
| At 31 December 2017 | 70,342 | 295,254 | 15,266,954 | 15,632,550 |

# Notes to the financial statements
# Year ended 31 December 2018

## 16. Intangible Assets

| | Computer software £ |
|---|---|
| **Cost** | |
| At 1 January 2017 | 482,571 |
| Additions | 231,468 |
| Translation difference | (11,630) |
| Foreign Exchange | 3,596 |
| | |
| At 31 December 2017 | 706,005 |
| | |
| Additions | 448,449 |
| Translation difference | (38,646) |
| Foreign Exchange | 1,263 |
| | |
| At 31 December 2018 | 1,117,071 |
| | |
| **Amortisation** | |
| At 1 January 2017 | 356,153 |
| Charge for the year | 129,010 |
| Disposals | (11,630) |
| Foreign Exchange | 3,272 |
| | |
| At 31 December 2017 | 476,805 |
| | |
| Charge for the year | 231,653 |
| Disposals | (38,645) |
| Foreign Exchange | 1,410 |
| | |
| At 31 December 2018 | 671,223 |
| | |
| **Net book value** | |
| At 31 December 2018 | 445,848 |
| | |
| At 31 December 2017 | 229,200 |

## 17. Goodwill

| | **2018** £ | **2017** £ |
|---|---|---|
| At cost | **751,540** | 751,540 |

Goodwill arose on the acquisition of the Bank of Nova Scotia portfolio of assets and liabilities ("the Business"). The Business has been integrated into the wider business of the Bank which is considered as the cash generating unit for goodwill impairment testing. The Bank tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The recoverable amount of the cash generating unit is determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates and growth rates. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the cash generating unit. The rate used to discount the forecast cash flows from the cash generating unit is 10.00 per cent being the cost of capital. The growth rates are based on industry growth forecasts. The Bank prepares cash flow forecasts derived from the most recent financial budgets approved by management for the cash generating unit and extrapolates cash flows for the review period based on the assumption that the cash flows will remain relatively stable throughout the period under review.

# Notes to the financial statements
# Year ended 31 December 2018

## 18. Deposits by banks

| | 2018 £ | 2017 £ |
|---|---|---|
| Repayable on demand | 218,691,869 | 187,338,286 |
| With agreed maturity dates or periods of notice, by remaining maturity: | | |
| Within three months | 98,517,661 | 71,198,943 |
| Between three months and one year | 40,123,289 | 48,435,193 |
| | | |
| | 357,332,819 | 306,972,422 |

Included in the above are amounts due to parent undertakings of £132,829,747 (2017: £119,239,133).

## 19. Customer accounts

| | 2018 £ | 2017 £ |
|---|---|---|
| Repayable on demand | 36,452,942 | 29,799,052 |
| With agreed maturity dates or periods of notice, by remaining maturity: | | |
| Within three months | 47,887,777 | 44,478,785 |
| Between three months and one year | 20,251,756 | 18,118,706 |
| Between one year and five years | - | - |
| | 104,592,475 | 92,396,543 |

## 20. Other liabilities

| | 2018 £ | 2017 £ |
|---|---|---|
| Other taxes and social security costs | 48,599 | 11,767 |
| Other liabilities | 1,646,090 | 951 |
| | | |
| | 1,694,689 | 12,718 |

## 21. Deferred tax liabilities

The components of taxes are as follows:

2018 £

| | Assets | Liabilities |
|---|---|---|
| Deferred tax | | |
| United Kingdom | 63,961 | - |
| | | |
| | 63,961 | - |

2017 £

| | Assets | Liabilities |
|---|---|---|
| Deferred tax | | |
| United Kingdom | - | (38,524) |
| | | |
| | - | ( 38,524) |

Deferred income taxes are calculated on all temporary differences under the liability method using effective rate of 17% (2017: 17%) Finance (No. 2) Act 2016 enacted reduction in the UK corporation tax rate to 19% with effect from 1 April 2017 and 17% with effect from 1 April 2020.

# Notes to the financial statements
# Year ended 31 December 2018

## 21. Deferred tax liabilities (continued)

The movement on the deferred income tax account is as follows:

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| At beginning of year | (38,524) | (38,745) |
| Income statement (charge)/credit | 102,485 | 221 |
| At end of year | 63,961 | (38,524) |

The deferred tax asset/(liability) is attributable to temporary differences arising in respect of the following items:

**Deferred income tax assets/ (liability)**

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Accelerated tax depreciation | 63,961 | (38,524) |
| Net deferred tax asset / (liability) | 63,961 | (38,524) |

## 22. Subordinated Loan

The Bank signed an agreement for the issue of a 10 Year Subordinated Loan ("the Loan") of USD 20 million on 19 March 2007 to Bank of Beirut Sal, its immediate and ultimate parent company. Drawdown was on 29 May 2007 with interest payable at 3 Month LIBOR + 1%, paid annually. At its meeting on 10 September 2012 the Board of Directors agreed to the following amendments of the Subordinated Loan Agreement:

- Interest payable on the loan at 3 Month LIBOR + 2% effective 30 November 2012
- Extension of the Loan maturity date to 29 May 2027

The Bank signed an agreement for the issue of a 15 Year Subordinated Loan ("the Loan") of GBP 16 million on 28 December 2017 with an effective date of 1 January 2018 to Bank of Beirut Sal, its immediate and ultimate parent company. Drawdown was on 2 January 2018 with interest payable at GBP 1 Year LIBOR + 4%, paid annually, the first interest payment date being 16 Jan 2019.

# Notes to the financial statements
# Year ended 31 December 2018

## 22. Subordinated Loan (Continued)

| | 2018 £ |
|---|---|
| As at 1 January 2018 | 14,826,705 |
| Additions | 16,000,000 |
| Accrued interest | 1,164,175 |
| Foreign exchange movements | 548,296 |
| | |
| **As at 31 December 2018** | 32,539,176 |

| | 2017 £ |
|---|---|
| As at 1 January 2017 | 16,211,634 |
| Accrued interest | 289,274 |
| Foreign exchange movements | (1,674,203) |
| | |
| **As at 31 December 2017** | 14,826,705 |

## 23. Called up share capital

| | 2018 £ | 2017 £ |
|---|---|---|
| Authorised | | |
| 50,000,000 ordinary shares of £1 each at beginning and end of the year | 50,000,000 | 50,000,000 |
| | | |
| Called up, allotted and fully paid | | |
| 34,150,000 (2016: 34,150,000 ) ordinary shares of £1 each at beginning of the year | 34,150,000 | 34,150,000 |
| | | |
| 34,150,000 ordinary shares of £1 each at end of the year | 34,150,000 | 34,150,000 |

## 24. Reconciliation of movements in shareholders' funds and movements on reserves

| | Called up share capital £ | Retained earnings £ | Total £ |
|---|---|---|---|
| As at 1 January 2017 | 34,150,000 | 62,454,076 | 96,604,076 |
| IFRS9 adjustment for first time adoption | | (1,383,611) | (1,383,611) |
| Comprehensive income for the year | | 5,565,723 | 5,565,723 |
| Other comprehensive income for the year | | 28,597 | 28,597 |
| | | | |
| As at 31 December 2018 | 34,150,000 | 66,664,785 | 100,814,785 |

## 25. Contingent liabilities

Contingent liabilities include an ECL of £147,914 and comprise:

| | 2018 £ | 2017 £ |
|---|---|---|
| Irrevocable letters of credit | 119,132,263 | 113,366,815 |
| Guarantees | 4,600,743 | 5,871,963 |
| | | |
| | 123,733,006 | 119,238,778 |

# Notes to the financial statements
# Year ended 31 December 2018

## 26. Commitments

| | 2018 £ | 2017 £ |
|---|---|---|
| Formal standby facilities, credit lines and other commitments to lend: | | |
| Less than one year | 80,003,203 | 64,538,648 |
| One year and over | 22,233,397 | 30,537,223 |
| | | |
| | 102,236,600 | 95,075,871 |

| | 2018 £ | 2017£ |
|---|---|---|
| Of which undrawn commitments are shown below and includes an ECL of £329 | 17,364,617 | 10,796,356 |

Operating lease arrangements:

| | 2018 £ | 2017 £ |
|---|---|---|
| Minimum lease payments under operating leases recognised as an expense in the year | 482,293 | 471,437 |

At the balance sheet date, the Bank had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

| | 2018 £ | 2017 £ |
|---|---|---|
| Not later than one year | 176,346 | 481,209 |
| Later than one year and not later than five years | 604,320 | 61,559 |
| More than 5 years | 483,456 | - |

Operating lease payments represent rentals payable by the Bank for its office properties. Leases are negotiated for an average term of 10 years and rentals are fixed for an average of five years with an option to extend for a further five years at the then prevailing market rate.

## 27. Related party transactions

During the year, the Bank entered into the following transactions with its holding company, Bank of Beirut, Sal:

| | 2018 £ | 2017 £ |
|---|---|---|
| Interest received from holding company | 279,507 | 167,345 |
| Interest paid to holding company | (2,829,738) | (1,744,899) |
| Fee paid to holding company | (233,318) | (222,907) |

Balances of the holding company as at the balance sheet date are as follows:

| | 2018 £ | 2017 £ |
|---|---|---|
| Deposits | | |
| Call Deposits | 96,120,891 | 70,003,961 |
| Fixed Deposits | 47,257,254 | 49,235,171 |
| Exposures to: | | |
| Bills Discounted | | 1,068,854 |
| Letters of Credit | 2,295,270 | 693,588 |
| Acceptances | 1,130,481 | 449,490 |

The interest rates charged to/from the holding company are at market rate and the balances are unsecured.

# Notes to the financial statements
# Year ended 31 December 2018

## 27. Related party transactions (continued)

### Directors' transactions

The following transactions have taken place with directors:
The Bank gave to two of its executive directors in 2018 unsecured non-interest bearing loans, payable within 12 months. These amounted to £2,248 (2017 - £2,208) in respect of personal travel costs and £2,380 (2017 - £2,222) related to private healthcare costs. Additionally, the Bank provided a non-interest bearing overdraft facility to one of its non-executive directors. The balance outstanding as at 31 December 2018 was £32,575 (2017 - £19,919).

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Deposits from Directors | 8,095,175 | 7,409,858 |

Deposits earn interest according to prevailing market rates as appropriate.

### Remuneration of key management personnel

The remuneration of the directors, who are the key management personnel of the Bank, is set out below in aggregate for each of the categories specified in IAS 24 Related Party Disclosures.

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Short-term employee benefits | 777,317 | 702,064 |
| Post-employment benefits | 40,838 | 49,853 |
| | 818,155 | 751,917 |

### Other Related Party Transactions

These balances include persons or close member of that person's family who have control or joint control over Bank of Beirut (UK) Ltd, significant influence over Bank of Beirut (UK) Ltd, or are a member of the key management personnel of Bank of Beirut (UK) Ltd or Bank of Beirut Sal (Lebanon).

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Deposits from other related parties | 3,193,558 | 2,882,837 |

Deposits are paid interest according to market rates as appropriate.

## 28. Ultimate parent and controlling party

The ultimate parent and controlling party at 31 December 2018 was Bank of Beirut Sal, which is incorporated in Lebanon. All of the Bank's issued share capital is wholly owned by Bank of Beirut Sal, which is the parent company of the smallest and largest groups into which the results of the Bank are consolidated. Copies of the group accounts can be obtained from 66 Cannon Street, London EC4N 6AE.

## 29. Financial instruments and risk management

The Bank holds and issues financial instruments for three main purposes:
- to earn an interest margin or a fee;
- to finance its operations; and
- to manage the interest rate and currency risks arising from its operations and from its sources of finance.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

The Bank does not have a trading book.

*As at the end of 31 December 2017 and 31 December 2018*, the carrying value of the financial assets and liabilities of the Bank approximates its fair value. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties in an arm's length transaction. Market values are used to determine fair values.

**Fair values of financial assets and liabilities**
The carrying amount of financial assets and liabilities approximates their fair value due to the short-term maturity of the majority of the financial assets and liabilities.

All loans and advances to customers are offered at floating rates and are recorded in the balance sheet using the effective interest rate method, less provision for impairment loss. This value is considered to be a good approximation for fair value.

The fair value of derivatives held for non-trading purposes is determined by market prices, or, where market prices are not available, by applying current market information to pricing or valuation models. The fair value hierarchy for the valuation of derivatives is level 2 – inputs other than quoted prices that are observable for the asset or liability which are derived indirectly (i.e. derived from prices).

As well as using derivatives to hedge foreign exchange exposure, the Bank takes exchange rate contract orders from customers and will cover these by entering into similar positions with the head office. Set out below is a year-end comparison of carrying values and fair values of the Bank's derivative instruments (spot deals are excluded) along with those entered into with third parties:

| As at 31 December 2017 | Notional principal Amount | Carrying value | | Fair value | |
|---|---|---|---|---|---|
| | £ | Asset £ | Liability £ | Asset £ | Liability £ |
| **Exchange rate-related contracts** | | | | | |
| Forward foreign exchange | 2,249,427 | 20,731 | 16,090 | 25,623 | 20,527 |
| Options | - | - | - | - | - |
| | | | | | |
| Totals | 2,249,427 | 20,731 | 16,090 | 25,623 | 20,527 |
| | | | | | |
| Of which third party | 2,249,427 | 20,731 | 16,090 | 25,623 | 20,527 |

| As at 31 December 2018 | Notional principal Amount | Carrying value | | Fair value | |
|---|---|---|---|---|---|
| | £ | Asset £ | Liability £ | Asset £ | Liability £ |
| **Exchange rate-related contracts** | | | | | |
| Forward foreign exchange | - | - | - | - | - |
| Options | - | - | - | - | - |
| | | | | | |
| Totals | - | - | - | - | - |
| | | | | | |
| Of which third party | - | - | - | - | - |

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### Classification of assets and liabilities

The assets are classified as follows:

| | Loans and receivables £ | Held to maturity £ | Fair value through profit and loss £ | Non-financial assets £ | Total £ |
|---|---|---|---|---|---|
| **As at 31 December 2017** | | | | | |
| Assets | | | | | |
| Cash and due from banks | 105,686,182 | - | - | - | 105,686,182 |
| Placements with banks | 181,949,007 | - | - | - | 181,949,007 |
| Loans and advances to customers | 178,336,200 | - | - | - | 178,336,200 |
| Customers' acceptances | 8,425,491 | - | - | - | 8,425,491 |
| Held to maturity investments: | | | | | |
| - Treasury bills and other eligible bonds | - | 3,014,495 | - | - | 3,014,495 |
| Available for sale: | | | | | |
| - UK Treasury bonds | - | - | 5,992,640 | - | 5,992,640 |
| - US Treasury bonds | - | - | 19,917,886 | - | 19,917,886 |
| Land & Buildings | - | - | - | 15,266,954 | 15,266,954 |
| Property and equipment | - | - | - | 365,596 | 365,596 |
| Intangible assets | - | - | - | 229,200 | 229,200 |
| Goodwill | | | | 751,540 | 751,540 |
| Derivative assets | - | - | 20,731 | | 20,731 |
| Prepayments and accrued income | - | - | | 818,178 | 818,178 |
| | | | | | |
| **Total assets** | **474,396,880** | **3,014,495** | **25,931,257** | **17,431,468** | **520,774,100** |

| | Loans and receivables £ | Amortised cost £ | FVTOCI £ | Non-financial assets £ | Total £ |
|---|---|---|---|---|---|
| **As at 31 December 2018** | | | | | |
| Assets | | | | | |
| Cash and due from banks | 180,059,533 | - | - | - | 180,059,533 |
| Placements with banks | 162,304,830 | - | - | - | 162,304,830 |
| Loans and advances to customers | 191,402,726 | - | - | - | 191,402,726 |
| Customers' acceptances | 9,843,804 | - | - | - | 9,843,804 |
| Debt securities at amortised cost | - | 1,585,826 | - | - | 1,585,826 |
| Financial assets at FVTOCI | | | | | |
| - UK Treasury bonds | - | - | 7,991,730 | - | 7,991,730 |
| - US Treasury bonds | - | | 32,691,530 | - | 32,691,530 |
| Land & Buildings | - | - | | 7,991,730 | 19,068,117 |
| Property and equipment | - | - | 32,691,530 | 967,527 | 967,527 |
| Intangible assets | | | | 445,848 | 445,848 |
| Goodwill | - | - | - | 751,540 | 751,540 |
| Derivative assets | - | - | - | - | - |
| Deferred tax assets | 63,961 | - | - | - | 63,961 |
| Prepayments and accrued income | - | - | - | 805,423 | 805,423 |
| | | | | | |
| **Total assets** | **543,674,854** | **1,585,826** | **40,683,260** | **22,038,455** | **607,982,395** |

Financial liabilities including deposits by bank, customer accounts, acceptance payable and subordinated loan are carried at amortised cost as at the balance sheet date. Derivative liabilities are carried at fair value to profit and loss at the balance sheet date. The Bank finances its operations by a mixture of shareholders' funds, customer deposits and inter-bank deposits. The deposits raised may be in a range of currencies at floating or fixed rates of interest. The Bank's lending is usually in sterling, Euros or US dollars and may be either floating or fixed rate. The Bank uses forward foreign exchange contracts to hedge foreign exchange exposures resulting from customer facilitation. All forward foreign exchange contracts for customers are matched with corresponding contracts with banks.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### Valuation hierarchy

The Bank holds financial instruments that are measured at fair value subsequent to initial recognition which consist of UK government securities (UK Treasury Bonds) as well as US government securities and derivative liabilities. These instruments have been categorised within one of the three levels using fair value hierarchy that reflects the significance of the inputs used in making the measurements. These levels are based on the degree to which the fair value is observable and are defined as follows:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities where prices are readily available and represent actual and regularly occurring market transactions on an arm's length basis. An active market is one in which transactions occur with sufficient frequency to provide on-going pricing information,
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly as prices or indirectly derived from prices; and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data ("unobservable inputs" ).

Investments classified as Level 1 comprise of UK government securities (UK Treasury Bonds) and US government securities (US Treasury Bonds). Investments classified as Level 2 comprise of over the counter derivatives.

| | Quoted Market prices (Level 1) £ | Valuation techniques using observable data (Level 2) £ | Valuation techniques using non-observable market data (Level3) £ |
|---|---|---|---|
| **Financial Assets** | | | |
| UK Treasury Bonds – Available For Sale | 5,992,640 | - | - |
| US Treasury Bonds – Available For Sale | 19,917,886 | - | - |
| Derivative assets | - | 20,731 | - |
| | | | |
| As at 31 December 2017 | 25,910,526 | 20,731 | - |
| | | | |
| **Financial Liabilities** | | | |
| Derivative Liabilities | - | 16,090 | - |
| | | | |
| As at 31 December 2017 | - | 16,090 | - |

| | Quoted Market prices (Level 1) £ | Valuation techniques using observable data (Level 2) £ | Valuation techniques using non-observable market data (Level3) £ |
|---|---|---|---|
| **Financial Assets** | | | |
| UK Treasury Bonds – FVTOCI | 7,991,730 | - | - |
| US Treasury Bonds – FVTOCI | 32,691,530 | - | - |
| Derivative assets | - | - | - |
| | | - | |
| As at 31 December 2018 | 40,683,260 | - | - |
| | | | |
| **Financial Liabilities** | | | |
| Derivative Liabilities | - | - | - |
| | | | |
| As at 31 December 2018 | - | - | - |

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

The key risks arising from the Bank's financial instruments are:
1. credit risk;
2. liquidity risk;
3. interest rate risk; and
4. foreign currency risk.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Management Committee to develop and monitor the Bank's risk management policies in their specified areas.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which employees understand their roles and obligations.

The Board have established a Board Audit, Risk & Compliance Committee which is constituted to ensure that the Executive Management has established and maintains an effective system of internal controls on behalf of the Board. It is also responsible for providing a channel of communication between the Board, the Management Committee, the Risk and Compliance functions, and Internal and External Audit.

The Board Audit, Risk & Compliance Committee also monitors compliance with the Bank's risk management policies and procedures and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Committee is assisted in these functions by Internal Audit and the Risk and Compliance departments. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, whilst Risk and Compliance provide quarterly reports the results of which are reported to the Board Audit, Risk & Compliance Committee.

### 29.1 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, sector and country concentration risk).

The Board of Directors has delegated responsibility for the management of credit risk to its Board Credit Committee and Management Committee. Their main duties include the approval of credit applications and credit provisions, the approval of credit policy and subsequent amendments.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.1 Credit risk (continued)

The Bank's maximum exposure to credit risk, by class of financial instrument is shown in the table below:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Carrying Value £ | Maximum Exposure £ | Carrying Value £ | Maximum Exposure £ |
| Placement with banks: | | | | |
| Loans and receivables | 162,304,830 | 162,304,830 | 181,949,007 | 181,949,007 |
| Loans and advances to customers: | | | | |
| Loans and receivables | 191,402,726 | 171,461,068 | 178,336,200 | 173,291,983 |
| | | | | |
| Derivative financial assets | | | | |
| Currency forwards | - | - | 20,731 | 20,731 |
| | | | | |
| Net letters of credit and guarantees | 113,889,203 | 83,320,406 | 110,813,287 | 92,624,900 |
| | | | | |
| Loan commitments (unutilised) | 17,364,617 | 15,750,278 | 10,796,356 | 9,284,212 |
| | | | | |
| | 484,961,376 | 432,836,582 | 481,915,581 | 457,170,833 |

As per IAS 39 the below table represents the comparative against the subsequent IFRS9 tables;

| | Loans and advances to customers 2017 £ |
|---|---|
| Carrying amount | 178,336,200 |
| | |
| Individually impaired | 1,661,355 |
| Allowance for impairment | (1,477,209) |
| Suspended interest | (17,082) |
| | |
| Carrying amount | 167,064 |
| | |
| Past due but not impaired | 5,282,279 |
| | |
| | |
| Neither past due nor impaired | 172,886,857 |
| | |
| Carrying amount | 178,336,200 |

All the financial assets held by the Bank are classified as Stage 1 which the exception of loans and advances to customers, which falls into all three stages.

Net impairment losses recognised in profit or loss consist of impairment in relation to more than one asset class, the majority of which relate to loans and advances to customers. The following table shows a breakdown of the impairment charge for the year by class of financial asset.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.1 Credit risk (continued)

#### Classes of financial assets

| | 2018<br>£ |
|---|---|
| Cash and balances at banks | 1,169 |
| Placement with banks | 1,388 |
| Loans and advances to customers | (1,038,510) |
| Amortised cost debt securities | 18,844 |
| Financial assets at FVTOCI | 300 |
| Acceptances | (34,825) |
| Contingent liabilities | 22,159 |
| Outstanding facilities | 423 |
| | |
| Total impairment losses | **(1,029,052)** |
| | |

The Bank's maximum exposure to credit risk, by class of financial instrument is shown in the table below:

**2018**

| Movement in provisions | 12-month ECL (Stage 1) 2018 £ | Lifetime ECL (Stage 2) 2018 £ | Lifetime ECL (Stage 3) 2018 £ | Total 2018 £ |
|---|---|---|---|---|
| At 1 January per IAS 39 | | | 1,477,209 | 1,477,209 |
| Adoption of IFRS 9 | 1,373,327 | 10,285 | | 1,383,612 |
| At 1 January per IFRS 9 sub-total | 1,373,327 | 10,285 | 1,477,209 | 2,860,821 |
| Movement in Stage 1 ECL | 117,993 | | | 117,993 |
| Movement in Stage 2 ECL | | (2,634) | | (2,634) |
| Movement in Stage 3 ECL | | | 913,693 | 913,693 |
| Foreign exchange and other movements | | | 80,744 | 80,744 |
| At 31 December | | | | |
| | **1,491,320** | **7,651** | **2,471,646** | **3,970,617** |

**2018**

| Movement in gross carrying amount of loans | Loans (Stage 1) 2018 £ | Loans (Stage 2) 2018 £ | Loans (Stage 3) 2018 £ | Total 2018 £ |
|---|---|---|---|---|
| At 1 January per IFRS 9 | 172,658,187 | 3,884,237 | 2,680,353 | 179,222,777 |
| Movement in Stage 1 | 15,740,036 | | | 15,740,036 |
| Movement in Stage 2 | | (333,759) | | (333,759) |
| Movement in Stage 3 | | | 649,840 | 649,840 |
| At 31 December | **188,398,223** | **3,550,478** | **3,330,193** | **195,278,894** |

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.1 Credit risk (continued)

**ECL sensitivity**

The Bank has adopted three macro-economic scenarios in calculating its ECL charge, namely Good, Base and Bad. The Bank has considered the impact of a general deterioration in the macro-economic factors as a means of applying a stress scenario to the overall ECL charge as at 31st December 2018. This has been modelled by applying different weightings to the scenarios used to calculate the charge. Gross exposures allocated to Stage 3 do not change as the criteria rely only on observable evidence of default and not on macro-economic scenarios. For Stage 1 and 2 exposures, the impact of applying the worst economic scenario in all cases would increase the ECL charge by 9.8% to £148,242 and is not considered material. Conversely, applying the good economic scenario to the same exposures would reduce the ECL charge by 12.3% to £185, 870.

**Allowances for impairment**

The calculation of the Bank's expected credit loss (ECL) allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Bank to make a number of judgements, assumptions and estimates. The main component is a specific loss provision that relates to individually significant exposures and represents the amount remaining after deducting the expected discounted cash flows from the outstanding loan principal and accrued interest at the balance sheet date. The level of impairment allowance will also be impacted by the staging applied to individual contracts under IFRS 9.

**Write-off policy**

The Bank writes off a loan balance (and any related allowances for impairment losses) when the Board determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

**Credit risk concentration**

The Bank manages credit risk concentration by setting exposure limits to groups/individual counterparties and countries. The Bank monitors credit risk concentration against limits daily. Any excesses, actual or potential, are notified by the Credit Department to the MD and CEO for ratification, approval and/or recommendation to the Management Committee / Board for direction as to remedial action.

The Bank's principal financial assets are placements with banks, loans and advances to customers and held to maturity investments – debt securities.

The Bank's credit risk is primarily attributable to its loans and advances to customers. The amount presented in the balance sheet is net of impairment losses. Impairment losses are recognised if there is objective evidence that an event or events since initial recognition of an asset have adversely affected the amount or timing of future cash flows from the asset.

The Bank is exposed to concentration risk due to its customer base being largely financial institutions predominantly located in the Middle East and Africa. In this respect the Bank continues to look at opportunities in an attempt to spread and grow its client base, both within the MEA region and externally, to mitigate this risk.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.1 Credit risk (continued)

**Credit risk concentration (continued)**

The table below summarises the sector and location concentration risk for the Bank at the year-end.

| Loans and advances to customers | 2018 £ | 2017 £ |
|---|---|---|
| Concentration by risk location | | |
| Great Britain | 7,061,663 | 13,651,996 |
| Europe | 6,115,530 | 10,969,491 |
| Africa | 140,017,734 | 125,302,870 |
| Rest of the world | 38,207,799 | 28,411,843 |
| | | |
| Total | 191,402,726 | 178,336,200 |

### 29.2 Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities.

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The liquidity position of the Bank is monitored daily, and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions.

The Bank's Treasury Department is responsible for maintaining sufficient liquidity to meet the Bank's obligations and to meet the specific liquidity requirements of the UK supervisory authorities. Daily liquidity reports are also reviewed by Risk for adherence to Board approved internal liquidity parameters. These figures are kept and reported to the Management Committee on a regular basis and the Audit, Risk & Compliance Committee quarterly. The key measure used by the Bank for managing liquidity risk is the ratio of behaviourally adjusted net liquid assets (maturing in less than one month) to total deposits.

In the unlikely event of a liquidity crisis the Treasury Department would immediately endeavour to sell the Bank's liquid assets, or if more expedient, seek additional funds from the shareholders or borrow in the market to alleviate the shortfall.

The table below shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance, and unrecognised loan commitments are not all expected to be drawn down immediately.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.2 Liquidity risk (continued)

| Residual contractual maturities of financial liabilities as at 31 December 2017 | Carrying amount £'000 | Less than one month £'000 | More than one month but not more than three months £'000 | More than three months but not more than one year £'000 | More than 1 year £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| Non-derivative liabilities | | | | | | |
| Deposits by banks | 306,972 | 187,338 | 71,199 | 48,435 | - | 306,972 |
| Customer accounts | 92,397 | 29,799 | 44,479 | 18,119 | | 92,397 |
| Subordinated loan | 14,827 | - | - | - | 14,827 | 14,827 |
| | | | | | | |
| | 414,196 | 217,137 | 115,678 | 66,554 | 14,827 | 414,196 |
| | | | | | | |
| Derivative liabilities | | | | | | |
| Forward foreign exchange contracts inflow | (2,234) | (996) | (1,002) | (236) | - | (2,234) |
| Forward foreign exchange contracts outflow | 2,229 | 993 | 1,000 | 236 | - | 2,229 |
| | (5) | (3) | (2) | - | - | (5) |
| | | | | | | |
| | 414,191 | 217,134 | 115,676 | 66,554 | 14,827 | 414,191 |

| Residual contractual maturities of financial liabilities as at 31 December 2018 | Carrying amount £'000 | Less than one month £'000 | More than one month but not more than three months £'000 | More than three months but not more than one year £'000 | More than 1 year £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| Non-derivative liabilities | | | | | | |
| Deposits by banks | 357,333 | 218,692 | 62,028 | 36,490 | 40,123 | 357,333 |
| Customer accounts | 104,592 | 36,453 | 19,573 | 28,314 | 20,252 | 104,592 |
| Subordinated loan | 32,539 | - | - | - | 32,539 | 32,539 |
| | | | | | | |
| | 494,464 | 255,145 | 81,601 | 64,804 | 92,914 | 494,464 |
| | | | | | | |
| Derivative liabilities | | | | | | |
| Forward foreign exchange contracts inflow | - | - | - | - | - | - |
| Forward foreign exchange contracts outflow | - | - | - | - | - | - |
| | | | | | | |
| | - | - | - | - | - | - |
| | 494,464 | 255,145 | 81,601 | 64,804 | 92,914 | 494,464 |

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.3 Interest rate risk

Interest rate risk is the risk that changes in interest rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of interest rate risk management is to manage and control interest rate risk exposure within acceptable parameters while optimising the return on risk.

The policy of the Bank is to price all placements/exposures at variable rates or at fixed rates for fixed periods on appropriate rollover dates that allow for matching in the market.

The tables shown below summarise the repricing mismatches on the Bank's assets and liabilities as at 31 December 2018 and 31 December 2017. Items are allocated to time bands by reference to the earlier of the next contracted interest rate repricing date and the maturity date.

Exposure to interest rate movements arise where there is an imbalance between variable rate and fixed rate and non-rate sensitive assets and liabilities. The table below shows the interest rate sensitivity gap exposures for the Bank as at 31 December 2018. Assets and liabilities are analysed in time bands according to the earlier of the time to the next interest re-pricing date or the maturity date.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.3 Interest rate risk (continued)

Interest rate sensitivity gap analysis 31 December 2017

| | Not more than 3 months £'000 | In more than three months but not more than six months £'000 | In more than six months but not more than twelve months £'000 | In more than one year but not more than five years £'000 | In more than five years £'000 | Non-interest bearing £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|
| Assets | | | | | | | |
| Cash and balances at banks | 19,168 | - | - | - | - | 86,518 | 105,686 |
| Placements with banks | 181,949 | - | - | - | - | - | 181,949 |
| Loans and advances to customers | 116,110 | 16,784 | 33,502 | 3,148 | 615 | 8,177 | 178,336 |
| Customers acceptances | - | - | - | - | - | 8,425 | 8,425 |
| Held to maturity investments: | | | | | | | |
| - Treasury bills and other eligible bills | - | - | - | 3,014 | - | - | 3,014 |
| Available for sale: | | | | | | | |
| -UK Treasury bonds | - | - | 5,993 | - | - | - | 5,993 |
| -US Treasury bonds | - | 15,482 | 4,436 | - | - | - | 19,918 |
| Land & Buildings | - | - | - | - | - | 15,267 | 15,267 |
| Property and equipment | - | - | - | - | - | 366 | 366 |
| Intangible assets | - | - | - | - | - | 229 | 229 |
| Goodwill | - | - | - | - | - | 752 | 752 |
| Derivative assets | - | - | - | - | - | 21 | 21 |
| Prepayments and accrued income | - | - | - | - | - | 818 | 818 |
| | | | | | | | |
| **Total assets** | 317,227 | 32,266 | 43,931 | 6,162 | 615 | 120,573 | 520,774 |
| | | | | | | | |
| Liabilities | | | | | | | |
| Deposits by banks | 162,641 | 37,344 | 11,091 | - | - | 95,896 | 306,972 |
| Customers' accounts | 44,479 | 18,119 | - | - | - | 29,799 | 92,397 |
| Acceptances payable | - | - | - | - | - | 8,425 | 8,425 |
| Accruals and deferred income | - | - | - | - | - | 312 | 312 |
| Derivative liabilities | - | - | - | - | - | 16 | 16 |
| Other liabilities | - | - | - | - | - | 13 | 13 |
| Tax liabilities | - | - | - | - | - | 155 | 155 |
| Deferred Tax Liability | - | - | - | - | - | 1,014 | 1,014 |
| Subordinated loan | - | - | - | - | - | 39 | 39 |
| Equity | 14,827 | - | - | - | - | - | 14,827 |
| | | | | | | | |
| **Total liabilities and equity** | - | - | - | - | - | 96,604 | 96,604 |
| | | | | | | | |
| Interest rate sensitivity gap | | | | | | | |
| Cumulative gap | 221,947 | 55,463 | 11,091 | 0 | 0 | 232,273 | 520,774 |

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.3 Interest rate risk (continued)

Interest rate sensitivity gap analysis 31 December 2017

| | Not more than 3 months £'000 | In more than three months but not more than six months £'000 | In more than six months but not more than twelve months £'000 | In more than one year but not more than five years £'000 | In more than five years £'000 | Non-interest bearing £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|
| Assets | | | | | | | |
| Cash and balances at banks | 159,408 | - | - | - | - | 20,651 | 180,059 |
| Placements with banks | 162,305 | - | - | - | - | - | 162,305 |
| Loans and advances to customers | 144,142 | 12,917 | 4,368 | 29,976 | - | - | 191,403 |
| Customers' acceptances | - | - | - | - | - | 9,844 | 9,844 |
| Debt securities at amortised cost: | | | | | | | |
| - Treasury bills | - | 773 | - | - | 813 | - | 1,586 |
| Financial assets at FVTOCI: | | | | | | | |
| - UK Treasury bonds | 7,992 | - | - | - | - | - | 7,992 |
| - US Treasury bonds | 21,826 | 10,865 | - | - | - | - | 32,691 |
| Land & Buildings | - | - | - | - | - | 19,068 | 19,068 |
| Property and equipment | - | - | - | - | - | 968 | 968 |
| Intangible assets | - | - | - | - | - | 446 | 446 |
| Goodwill | - | - | - | - | - | 751 | 751 |
| Derivative assets | - | - | - | - | - | - | - |
| Deferred tax assets | - | - | - | - | - | 64 | 64 |
| Prepayments and accrued income | - | - | - | - | - | 805 | 805 |
| | | | | | | | |
| Total assets | 495,673 | 24,555 | 4,368 | 29,976 | 813 | 52,597 | 607,982 |
| | | | | | | | |
| Liabilities | | | | | | | |
| Deposits by banks | 217,552 | 40,123 | - | - | - | 99,658 | 357,333 |
| Customers' accounts | 56,566 | 19,080 | - | - | - | 28,946 | 104,592 |
| Acceptances payable | - | - | - | - | - | 9,915 | 9,915 |
| Accruals and deferred income | - | - | - | - | - | 449 | 449 |
| Derivative liabilities | - | - | - | - | - | - | - |
| Other liabilities | - | - | - | - | - | 1,695 | 1,695 |
| Provision for liabilities and charges | - | - | - | - | - | 95 | 95 |
| Tax liabilities | - | - | - | - | - | 549 | 549 |
| Subordinated loan | 32,539 | - | - | - | - | - | 32,539 |
| Equity | - | - | - | - | - | 100,815 | 100,815 |
| | | | | | | | |
| Total liabilities and equity | 306,657 | 59,203 | - | - | - | 242,122 | 607,982 |
| | | | | | | | |
| Interest rate sensitivity gap | 189,016 | (34,648) | 4,368 | 29,976 | 813 | (189,525) | - |
| Cumulative gap | 189,016 | 154,368 | 158,736 | 188,712 | 189,525 | - | - |

The tables above provide only an indication of the sensitivity of the Bank's earnings to movements in interest rates and are consistent with the position throughout the accounting period.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.3 Interest rate risk (continued)

A liability (or negative) gap position exists when liabilities reprice more quickly than assets during a given period and tends to benefit net interest income in a declining interest rate environment. An asset (or positive) gap position exists when assets reprice more quickly than liabilities during a given period and tends to benefit interest income in a rising interest rate environment. The Bank's off balance sheet items carry no interest repricing risk. The table below shows the weighted average interest rates received and paid for each class of financial asset and financial liability exposed to interest rate risk.

| | 2018 | 2017 |
|---|---|---|
| Financial assets | | |
| Placements with banks | 1.23% | 0.69% |
| Loans and advances to customers | 6.36% | 5.47% |
| Treasury bills | 1.83% | 2.73% |
| | | |
| **Financial liabilities** | | |
| **Deposits by banks** | 0.89% | 0.48% |
| Customer Accounts | 0.67% | 0.60% |

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various interest rate scenarios. The table below shows the impact on annual profit of a 100 basis point rise or fall in the base rate, and assumes a constant balance sheet position:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | 100 basis points increase £'000 | 100 basis points decrease £'000 | 100 basis points increase £'000 | 100 basis points decrease £'000 |
| Increase/(decrease) in annual profit | 409 | (423) | 644 | (669) |

### 29.4 Foreign exchange risk

Foreign exchange risk is the risk that changes in foreign currency rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of foreign currency risk management is to manage and control foreign currency risk exposure within acceptable parameters while optimising the return on risk.

Foreign exchange exposure arises from normal banking activities, primarily from the receipt of deposits and the placement of funds. Future open positions in any currency are managed by means of forward foreign exchange contracts. It is the policy of the Bank that it will, at all times, adhere to the limits laid down by CRDIV in respect of the "overall net open position". It is not the Bank's intention to take open positions on its own account (proprietary trading) but rather to maintain square or near square positions in all currencies.

The Bank does not currently deal, and has no plans to deal, in Foreign Exchange Futures, Foreign Exchange Options or Options on Foreign Exchange Futures.

The table in note 29 gives details of the notional principal amounts and fair values as at 31 December 2018 and 31 December 2017.

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.4 Foreign exchange risk (continued)

The tables shown below give details of the Bank's assets and liabilities as at 31 December 2018 and 31 December 2017, in sterling, based on the currencies in which they are denominated to identify the extent to which the foreign currency exposures of the Bank are matched.

| | Sterling £'000 | US dollars £'000 | Euros £'000 | Other currencies £'000 | Total £'000 |
|---|---|---|---|---|---|
| **As at 31 December 2017** | | | | | |
| **Assets** | | | | | |
| Cash and due from banks | 2,579 | 21,860 | 79,556 | 1,691 | 105,686 |
| Placements with Banks | 85,000 | 73,938 | 23,011 | - | 181,949 |
| Loans and advances to customers | 27,633 | 135,371 | 15,332 | - | 178,336 |
| Customers' acceptances | 635 | 6,372 | 1,418 | - | 8,425 |
| Held to Maturity investments: | | | | | |
| - Treasury bills and other eligible bills | - | 3,014 | - | - | 3,014 |
| - UK Treasury bonds | 5,993 | - | - | - | 5,993 |
| - US Treasury bonds | - | 19,918 | - | - | 19,918 |
| Goodwill | 752 | - | - | - | 752 |
| Land & Building | 15,267 | - | - | - | 15,267 |
| Property and equipment | 337 | - | 29 | - | 366 |
| Intangible assets | 223 | - | 6 | - | 229 |
| Derivative assets | 21 | - | - | - | 21 |
| Prepayments and accrued income | 706 | 2 | 110 | - | 818 |
| | | | | | |
| **Total assets** | 139,146 | 260,475 | 119,462 | 1,691 | 520,774 |
| | | | | | |
| **Liabilities** | | | | | |
| Deposits by banks | 24,314 | 171,840 | 109,924 | 894 | 306,972 |
| Customer accounts | 19,013 | 66,496 | 6,180 | 708 | 92,397 |
| Acceptances payable | 636 | 6,372 | 1,418 | - | 8,426 |
| Accruals and deferred income | 176 | 69 | 67 | - | 312 |
| Derivative liabilities | 16 | - | - | - | 16 |
| Other liabilities | 13 | - | - | - | 13 |
| Provision for liabilities and charges | 155 | - | - | - | 155 |
| Tax liabilities | 780 | - | 234 | - | 1,014 |
| Deferred tax liability | 38 | - | - | - | 38 |
| Subordinated loan | - | 14,827 | - | - | 14,827 |
| | | | | | |
| **Total liabilities** | 45,141 | 259,604 | 117,823 | 1,602 | 424,170 |
| | | | | | |
| **Net assets/(liabilities)** | 94,005 | 871 | 1,639 | 89 | 96,604 |

# Notes to the financial statements
# Year ended 31 December 2018

## 29. Financial instruments and risk management (continued)

### 29.4 Foreign exchange risk (continued)

| | Sterling £'000 | US dollars £'000 | Euros £'000 | Other currencies £'000 | Total £'000 |
|---|---|---|---|---|---|
| As at 31 December 2018 | | | | | |
| Assets | | | | | |
| Cash and due from banks | 4,290 | 29,312 | 145,862 | 595 | 180,059 |
| Placements with Banks | 89,996 | 50,781 | 21,528 | - | 162,305 |
| Loans and advances to customers | 22,779 | 160,778 | 7,846 | - | 191,403 |
| Customers' acceptances | 1,308 | 6,860 | 1,676 | - | 9,844 |
| Debt securities at amortised cost: | | | | | |
| - Treasury bills | - | 1,586 | - | - | 1,586 |
| Financial assets at FVTOCI | | | | | |
| - UK Treasury bonds | 7,992 | - | - | - | 7,992 |
| - US Treasury bonds | - | 32,691 | - | - | 32,691 |
| Goodwill | 751 | - | - | - | 751 |
| Land & Building | 19,068 | - | - | - | 19,068 |
| Property and equipment | 938 | - | 30 | - | 968 |
| Intangible assets | 371 | - | 75 | - | 446 |
| Deferred tax assets | 64 | - | - | - | 64 |
| Prepayments and accrued income | 625 | 9 | 171 | - | 805 |
| | | | | | |
| **Total assets** | **148,182** | **282,017** | **177,188** | **595** | **607,982** |
| | | | | | |
| Deposits by banks | 13,971 | 185,068 | 157,908 | 386 | 357,333 |
| Customer accounts | 15,475 | 74,321 | 14,589 | 207 | 104,592 |
| Acceptances payable | 1,308 | 6,931 | 1,676 | - | 9,915 |
| Accruals and deferred income | 140 | 235 | 74 | - | 449 |
| Derivative liabilities | - | - | - | - | - |
| Other liabilities | 1,695 | - | - | - | 1,695 |
| Provision for liabilities and charges | 95 | - | - | - | 95 |
| Tax liabilities | 534 | - | 15 | - | 549 |
| Subordinated loan | 16,509 | 16,030 | - | - | 32,539 |
| | | | | | |
| Total liabilities | **49,727** | **282,585** | **174,262** | **593** | **507,167** |
| | | | | | |
| **Net assets/(liabilities)** | **98,455** | **(568)** | **2,926** | **2** | **100,815** |

The carrying amounts of derivative assets and liabilities represent fair values and have been included in the heading of sterling currency. Foreign exchange risk on these instruments has been reflected through the currency swaps off balance sheet line, which represents the notional principal amounts in respect of forward foreign exchange derivatives utilised for managing the foreign exchange risk position of the Bank.

## 30. Capital risk management

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Bank's overall strategy remains unchanged.

The capital structure of the Bank consists of shareholders' equity comprising issued capital and retained earnings as disclosed in note 23 and 24 as well as subordinated loans as disclosed in note 22.

# Notes to the financial statements
# Year ended 31 December 2018

## 31. Collateral

Of the total amount of loans classified as Stage 3, the Bank holds collateral valued at £1,641,796 (2017 - £0) in the form of property on a loan with a carrying value of £229,111 (2017 - £0). We expect that this collateral will cover the exposure.

## 32. Events after the audit reporting period

### Frankfurt Branch

At its meeting in February 2019 and in the light of continuing uncertainty in the UK's departure from the European Union, a decision was taken by the Board of Directors to close its Frankfurt Branch operation which is licenced under the current EU Passport regime. An estimate of the expected costs associated with this event is not fully determinable at this time.